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MONITORING COUNTRY PROGRESS IN CENTRAL AND EASTERN EUROPE & THE NEW INDEPENDENT STATES

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EXECUTIVE SUMMARY

I. Introduction

The programs of U.S. assistance to Central and Eastern Europe (CEE) and to the New Independent States (NIS) of the former Soviet Union have been envisioned, since their inception, as short-term programs to jump start the countries of this strategically critical region on their way to political and economic transitions. It is essential, therefore, to monitor not only the impact of the U.S. assistance programs, but also the progress of the countries more generally to determine whether continued assistance is necessary or justified. This paper presents USAID/ENI's system for monitoring country progress with a focus on developing criteria towards graduation from USAID assistance.

II. Methodology

Country progress is analyzed in a sequence of steps for twenty-five countries of the region. First, we look at the progress towards economic reforms and democratization. The promotion of both are the two pillars of USAID's program in the region. Progress on both fronts must reach a certain threshold before we can begin to consider graduation.

Next, we look at indications of sustainability; that is, macroeconomic performance and social conditions. Economic reforms need to translate into solid macroeconomic performance if they are to be sustained. Trends in social conditions need to be tracked as well to give us a pulse on the possibilities of economic and democratic "reform fatigue" as well as fiscal sustainability.

For most indicators, proposed graduation benchmarks are assigned. Failure of a country to meet a benchmark is intended to signal a "yellow flag" in the mind of the analyst; an aspect that may need to be examined more thoroughly if graduation is being considered on the basis of other evidence.

The indicators are drawn from standard, well-established data sources that are external to USAID. The primary sources are the EBRD, Freedom House, and the World Bank. Supplemental sources include the IMF, and the UNDP, and the Bureau of Census.

An important step of the process is the holding of annual reviews—one for CEE, one for the NIS—of the data prior to the spring USAID program reviews. These reviews are to serve as a reality check on the data and our interpretation of it.

III. Analysis

The *Summary Table* below provides an overall picture of the status of the economic policy reforms (through August 1997) and democratic freedoms (through 1996). *Figure 1* portrays these data in part to help ascertain how and to what extent economic policy and democratization might be linked.

Salient observations. As revealed in *Figure 1*, there seem to be three groups of countries differentiated by progress towards economic and democratic reforms. The Northern Tier countries, less Slovakia, consist of one group, and are substantially out front, particularly in democratic reforms. The laggards appear to consist of six countries: the Central Asian Republics (less Kyrgyzstan), Belarus, and Azerbaijan. The middle group is the largest and includes the Southern Tier CEE countries, Russia, Ukraine, and other NIS. In general, this middle group may be where U.S. foreign assistance can realize the greatest return on its investment; where needs are great, and the quality of partnership (with exceptions) is relatively high.

The spread in progress between the three groups is more evident in democratization than it is in economic reforms. Six of the Northern Tier countries now have democratic standards roughly comparable to many Western democracies. Two Central Asian Republics rank among the least democratic worldwide.

Linked to this trend is the observation that economic policy reforms in the region, relative to the standards in the industrial market economies, have far to go, even in the Northern Tier countries.

Figure 1 also reveals a close correspondence between economic and political liberalism. The trend line highlights that progress in both reform areas tend to go hand-in-hand. Progress in both areas is the most advanced in Hungary, the Czech Republic, and Poland. Turkmenistan, Tajikistan, Azerbaijan, Belarus, and Uzbekistan rank towards the bottom in both areas.

Recent (1996 through mid-1997) trends reinforce the tendency for economic and democratic reforms to be positively linked. Recent backsliding has occurred in both economic and democratic reforms in Belarus, Slovakia, and Albania. Moreover, significant progress in economic reforms has occurred recently in Georgia and Azerbaijan and has been accompanied by an increase in civil liberties in both countries.

Only Belarus experienced a net deterioration in economic policy reforms from 1994 to 1997. There have been, however, a number of partial setbacks recently in economic reforms; in particular, in Albania, Uzbekistan, Slovakia, as well as Belarus.

Progress in economic policy reforms in the past year, nevertheless, has outweighed the backsliding. In fact, sixteen of the twenty-five countries showed measurable progress from mid-1996 to mid-1997. The most broad-based progress was witnessed by Bulgaria, followed by Georgia, Azerbaijan, Russia, Hungary, and Turkmenistan.

Trends over the past year reinforce the tendency for progress in economic reforms to be most evident among those countries at an intermediate stage in the transition process. Progress in countries at a more advanced transition stage has tended to be slower in large part because the remaining reforms among the leaders are the most difficult and take the most time to implement and enforce.

Five countries experienced a net deterioration in both political and civil liberties from 1991 to 1996. All are NIS: Uzbekistan, Turkmenistan, Tajikistan, Kazakhstan, and Belarus. In 1996, there were more countries which witnessed an increase in democratic freedoms (nine countries) than there were those which showed deterioration (five).

Many contrasts among the transition economies in terms of macroeconomic performance and social conditions mirror the often-times stark differences in economic reforms and democratization. These include:

(a) Robust economic growth is occurring in the Northern Tier CEE countries (close to five percent on average since 1994). Strong economic growth in 1994-1995 in the Southern Tier CEE has given way to economic contraction for the region as a whole in 1997. For the NIS, 1997 may be the first transition year of positive economic growth.

(b) Seven countries (six Northern Tier countries, Russia, and Albania) now have a private sector as a percent of GDP that is seventy percent or higher, comparable to that found among OECD countries. In contrast, six countries (all NIS) still have economies in which more than fifty percent of economic activity derives from the public sector.

(c) Income inequality and poverty tend to be much greater in the NIS than in CEE; the poverty rate may be close to forty percent in the NIS relative to roughly ten percent in the Northern Tier CEE countries.

(d) Infant mortality rates are significantly lower in the Northern Tier countries than in the Southern Tier and the NIS. Moreover, Northern Tier rates have fallen significantly (twenty percent) since 1989. Progress is much more modest in the Southern Tier where rates have fallen five percent and negligible on balance in the NIS.

IV. Concluding Remarks

Making appropriate decisions on the magnitude and duration of U.S. assistance to countries of the ENI region requires consideration of much more than country progress and need. Other key factors include:

(a) the strategic importance of the country to the U.S.;

(b) the importance of the recipient country to U.S. citizens;

(c) the effectiveness of particular assistance activities.

The first two factors are considered by USAID and by the State Department-based Coordinators for U.S. Assistance to both CEE and the NIS in setting annual assistance levels for each country. The effectiveness of the assistance is assessed through the annual collection of data on established performance targets and through occasional project evaluations and sectoral impact evaluations.

Within this broader policy context, USAID will collect, analyze, and report on the country performance indicators semi-annually. These data will be provided to the State Department-based Coordinators for U.S. Assistance to CEE and the NIS and discussed with them, along with assessments of the other three factors listed above, when country planning levels are determined each winter. Particular country levels will likely be shaped in part by whether a given country falls into one of three categories, based on the analysis of country performance indicators:

(a) Countries ranked near the top of the list are obvious candidates for earlier "graduation."

(b) Countries near the bottom of the list may fall into one of three contrasting categories: (i) those where assistance is least likely to be effective, in which case it may make sense to close those programs down altogether or to keep highly targeted funding at minimal levels until their commitment to reform increases; (ii) those where reform now appears likely but requires greater resources; or (iii) those which possess characteristics that match well with the Agency's priorities for sustainable development programs.

(c) Countries in the middle of the list are likely candidates for continuing programs through existing funding mechanisms, as long as the assistance is effective and Congress continues to appropriate funds for this purpose. From these countries we would expect to see the next group of candidates to graduate.

Finally, country progress indicators can play a role in shaping not just the duration and size of USAID's program in a particular country, but, in broad strokes, the nature of the program as well. Are the mission's basic priorities appropriate?

Summary Table: Economic Policy Reforms and Democratic Freedoms in CEE & The NIS

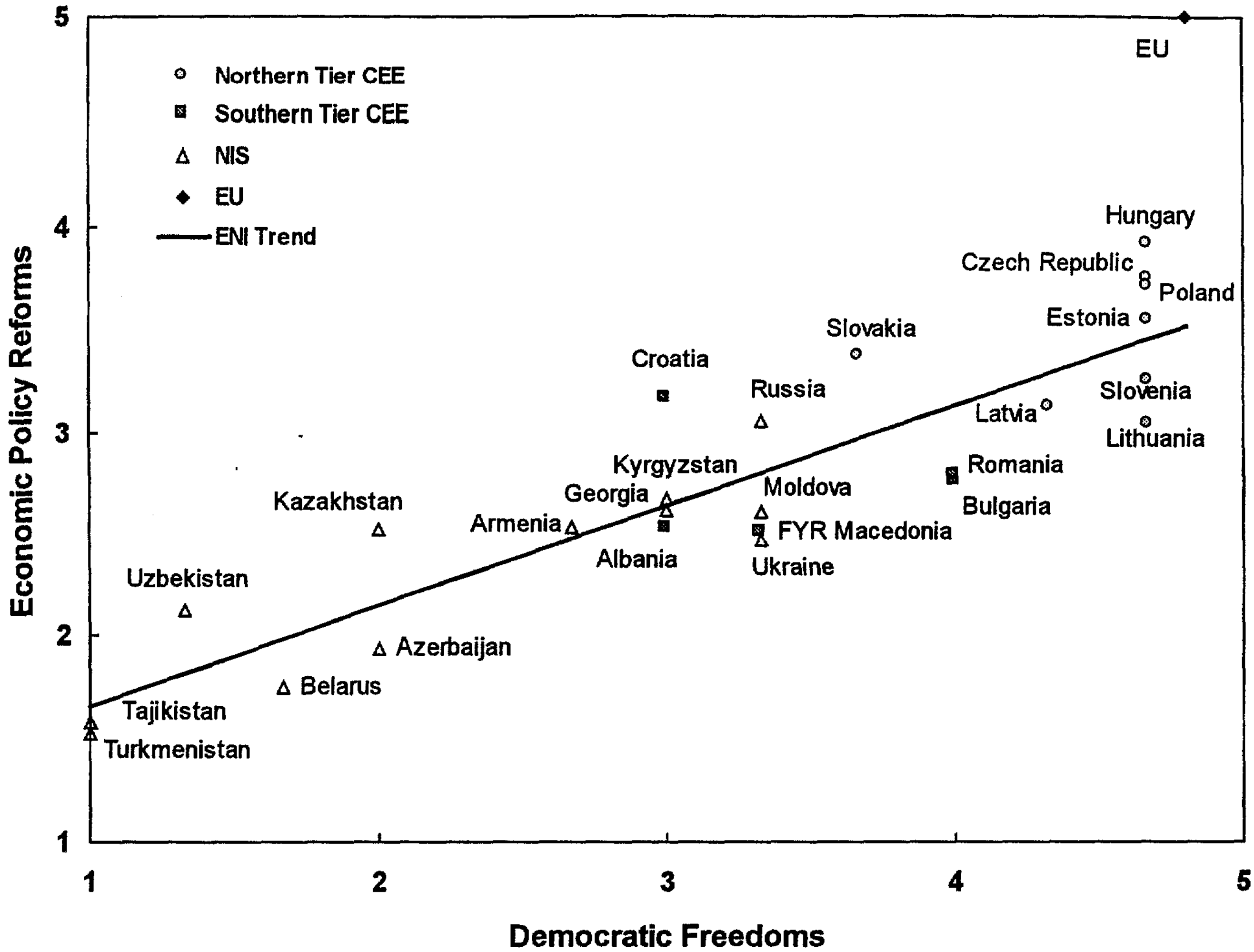
Economic Policy			Democratic Freedoms		
Country	Rating (1 to 5)	Ranking	Country	Rating (1 to 5)	Ranking
Hungary	3.9	1	Hungary	4.7	1
Czech Republic	3.8	2	Czech Republic	4.7	1
Poland	3.7	3	Poland	4.7	1
Estonia	3.5	4	Estonia	4.7	1
Slovakia	3.4	5	Slovenia	4.7	1
Slovenia	3.2	6	Lithuania	4.7	1
Croatia	3.2	6	Latvia	4.3	7
Latvia	3.1	8	Bulgaria	4.0	8
Russia	3.0	9	Romania	4.0	8
Lithuania	3.0	9	Slovakia	3.7	10
Romania	2.8	11	FYR Macedonia	3.3	11
Bulgaria	2.7	12	Moldova	3.3	11
Kyrgyzstan	2.7	12	Russia	3.3	11
Georgia	2.6	14	Ukraine	3.3	11
Moldova	2.6	14	Albania	3.0	15
Armenia	2.5	16	Croatia	3.0	15
Albania	2.5	16	Georgia	3.0	15
Kazakhstan	2.5	16	Kyrgyzstan	3.0	15
FYR Macedonia	2.5	16	Armenia	2.7	19
Ukraine	2.5	16	Azerbaijan	2.0	20
Uzbekistan	2.1	21	Kazakhstan	2.0	21
Azerbaijan	1.9	22	Belarus	1.7	22
Belarus	1.8	23	Uzbekistan	1.3	23
Tajikistan	1.6	24	Tajikistan	1.0	24
Turkmenistan	1.5	25	Turkmenistan	1.0	24

	Economic Policy Rating (1 to 5)	Democratic Freedoms Rating (1 to 5)
CEE & NIS	2.9	3.3
Northern Tier CEE	3.7	4.6
Southern Tier CEE	2.8	3.8
NIS	2.7	2.9
European Union	5.0	4.8
OECD	--	4.6

Note: Ratings are on a 1 to 5 scale, with 5 representing most advanced. Bosnia-Herzegovina rates a "2.1" on democratic freedoms, Yugoslavia (Serbia & Montenegro) earned a "1.4" on democratic freedoms.

Source: Economic Policy ratings are from EBRD, *Transition Report 1997* (November 1997); democracy ratings are from Freedom House, *Nations in Transit 1997* (April 1997) and *Freedom in the World 1996-1997* (1997).

Figure 1: Economic Policy Reforms and Democratic Freedoms in CEE and the NIS



Note: Ratings based on 1 to 5 scale, with 5 representing most advanced.
Source: EBRD, *Transition Report 1997* (November 1997), Freedom House, *Nations in Transit 1997* (April 1997).

MONITORING COUNTRY PROGRESS

I. Introduction

The programs of U.S. assistance to Central and Eastern Europe (CEE) and to the New Independent States (NIS) of the former Soviet Union have been envisioned, since their inception, as short-term programs to jump start the countries of this strategically critical region on their way to political and economic transitions. The objective is to help move these countries far enough along the road to becoming market-based democracies that they can complete the journey themselves.

It is, therefore, essential to monitor both the impact of the U.S. assistance programs themselves to maximize their effectiveness (*program impact monitoring*), as well as the progress of the countries more generally to determine whether continued assistance is necessary or justified (*country progress monitoring*). Program impact monitoring is done through a system of setting results targets and annually monitoring progress toward them and through less frequent special field evaluations. This paper presents USAID/ENI's system for monitoring country progress in twenty-five countries of the region.[1]

Country progress monitoring is done in part to determine whether the assistance program can be terminated either because: (a) the country is well launched on its way to a successful transition and cessation of assistance will no longer jeopardize that transition (i.e., graduation); or (b) the country is making so little progress that significant resources will have little impact. Monitoring is done semi-annually and results are shared with the State Department-based Coordinators for U.S. Assistance to each of the two regions. The Coordinators are charged with, among other things, determining the magnitude and duration of these transition assistance programs.

Section II below highlights the methodology. This is followed in Section III by analyses in each of the major areas examined: (a) **economic policy reforms**; (b) **democratization**; (c) **macro-economic performance**; and (d) **social conditions**. Section IV concludes. *Appendix I* elaborates on the rating schemes of the economic policy reform and democratization indicators. *Appendix II* addresses in preliminary fashion an important part of the overall picture which does not emerge from the official statistics; namely, trends in unofficial economic activity, and some implications.[2]

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[1]Analyses of Bosnia-Herzegovina and Yugoslavia (Serbia & Montenegro) will be included as data become available.

[2]For comparison between the transition economies and a select sample of countries outside the region, see USAID/ENI, *The Transition Economies in the Global Context.* This working paper stems from Appendix III of previous editions of *Monitoring Country Progress.*

II. Methodology

Market-oriented reforms and democratization are the two pillars of USAID's program in the ENI region.[3] The challenge of this analysis thus is essentially to make assessments of the progress on both fronts, with a particular focus on the sustainability of reforms.

Country progress is hence analyzed in a sequence of steps drawing from standard, well-established data sources that are external to USAID. First, we look at the progress towards economic reforms and democratization. Progress on both fronts must reach a certain threshold before we can begin to consider graduation.

Economic policy reforms are assessed by drawing from EBRD's rating scheme of transition indicators, and supplemented by a similar scheme from Freedom House. Progress in democratic freedoms is determined from Freedom House's rating of civil liberties and political rights, and from an initial effort on its part to further disaggregate the measurement of such freedoms.

Next, we look at indications of sustainability. Economic reforms need to translate into solid macroeconomic performance. If the implementation of economic policies is determined to be sufficient in a particular country and yet the economy is performing poorly, then they are not there yet. We might expect improved performance to kick in with a lag. But evidence of good macroeconomic performance would give us more confidence that the reformed economy is self-sustaining.

Furthermore, it is important to underscore that acceptable progress in the reforms must precede good macroeconomic performance. A cross-country snapshot might show one economy outperforming another in part because painful reforms have been avoided in the former. Yet, this is hardly sustainable.

The macroeconomic performance indicators also provide a check on the comprehensiveness of the economic reform indicators. For example, fiscal reform—or, more broadly, the role of the state in the provision of social services—is likely not adequately addressed in the current mix of economic reform indicators. Yet, insufficient fiscal reform is likely to surface in the form of bloated fiscal deficits, and this *is* being tracked as an economic performance indicator.

Another means to measure the sustainability of both economic and political reforms is to assess trends in social conditions. This is largely the concern of "reform fatigue." The populace may not

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[3]USAID assistance to ENI countries is funded through the Support for East European Democracy Act (SEED) and the Freedom Support Act (FSA), the latter applying to the NIS. The SEED Act has two goals: the promotion of democracy and a market-oriented economy. The FSA objectives are broader in scope, including the transition goals of the SEED Act as well as those focused more directly on humanitarian, social, environmental, and trade and investment conditions.

continue to support difficult reforms if the standard of living for many declines drastically. It may not be good enough, in other words, to have sound economic policies in place, solid macroeconomic performance, and extensive political and civil liberties, if a significant proportion of the population is losing out on balance.

Trends in social conditions also link to fiscal sustainability. Deteriorating social conditions may have a significant impact on social expenditures. Similarly, demographic changes may have substantial repercussions on pension systems.

For most indicators, proposed graduation benchmarks are assigned. Some are more arbitrary than others and need to be held to debate. Should a country fail to meet a benchmark, this should signal a "yellow flag" in the mind of the analyst; an aspect that may need to be examined more thoroughly if graduation is being considered on the basis of other evidence. The number of benchmarks a country needs to achieve should vary according to context.

An important step of the process is the holding of annual reviews—one for CEE, one for the NIS—with area specialists from U.S. government agencies prior to USAID's spring program review. Soliciting such expert opinion serves as a reality check on the data and our interpretation of it.

Finally, it merits explicitly recognizing that what is occurring in the region is unprecedented, and that there is little if any theoretical and/or empirical basis for devising precise thresholds of reform sustainability. Further, it is reasonable to assume that there is more than one acceptable transition route, or, what may amount to the same, many possible varieties of sustainable market-oriented democracies. This exercise, in short, is likely to be as much art as it is science, and it is important to place the results in this context.

III. Analysis

A. Economic Policy Reforms

Progress towards economic policy reforms is primarily assessed from indicators drawn from the EBRD's annual *Transition Report*, published in November. Sufficient progress must entail both an adequate threshold of reform as well as a favorable trend over time; that is, no significant policy backsliding.

Ten indicators are taken from EBRD's *Transition Report 1997* (November 1997) and compared with comparable indicators from EBRD's previous three annual reports:

(a) price liberalization;

(b) trade and foreign exchange reforms;

(c) small-scale privatization;

(d) large-scale privatization;

(e) enterprise restructuring policy;

(f) banking reform;

(g) non-bank financial reforms;

(h) competition policy;

(i) investment-related legal reforms; and

(j) environmental policy reforms.[4]

The indicators are measured on a one-to-five scale, with gradations in between.[5] A "five" represents standards and performance norms typical of advanced industrial economies. In general, depending on the particular indicator, a "3" or a "4" may very well be the threshold that we seek. Descriptions of the rating categories are provided in *Appendix I.* Included is an elaboration of the components that went into the environmental policy reform indicator.

These indicators focus on critical economic reform aspects of liberalization and institution-building in the transition process. Such reforms provide much of the overall enabling environment that is required for the emergence of a vibrant and sustainable market economy. While we review the reforms in stages below, it is important to recognize the existence of strong complementarities among them all, and the possibilities for synergism that derive from implementation of the total policy package. The other side to this is the possibility that insufficient progress in one reform aspect may undermine the potential gains from progress of another.

First Round Reforms. Following EBRD's lead, we group these indicators according to three stages in the reform process. The first round reforms consist of liberalization of prices, external trade and currency arrangements, and privatization of small-scale units.

Price liberalization focuses on the decontrolling of wages and product market prices, including

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[4]An environmental policy reform indicator is created from several indicators analyzed in EBRD (November 1997). Elaboration of the components is given in *Appendix I.*.

[5]The EBRD differentiates between a "4" and a "4*". For simplicity, their "4*" becomes our "5". Also, we measure EBRD's "+" as a "0.3", and a "-" as a "-0.3".

key infrastructure products such as utilities and energy, and the phasing out of state procurement at non-market prices.[6] ***Trade and foreign exchange reforms*** focus on the removal of trade restrictions (export tariffs, quantitative and administrative import and export restrictions, membership in the WTO), and improving access to foreign exchange (current and capital account convertibility). ***Small-scale privatization*** includes small firms, small farms and plots of land, and housing.

Alongside the growth of new firms, privatization is an essential aspect towards restructuring the economy into one that is private-sector driven. Price liberalization provides the appropriate incentives through market-based prices to better maximize efficiency. Trade and foreign exchange reforms provide further discipline for the private sector through global competition, as well as providing domestic firms with a greater capacity to compete.

In many respects, these first round reforms, which require relatively little institution building, have been the easiest. In fact, in CEE they have generally been adopted rapidly and quite thoroughly. By mid-1995, arguably all CEE countries but Bulgaria and Romania had advanced significantly towards achieving these reforms.[7] Moreover, most Northern Tier countries have achieved standards in small-scale privatization and trade and foreign exchange systems that are comparable to those of the advanced industrial economies. Among the NIS, in contrast, perhaps only Kyrgyzstan, Russia, and Georgia have progressed sufficiently in this domain. *Table 1* below shows the status of these reforms as of August 1997. Appendix I describes the rating categories.

Second Round Reforms. These reforms focus on large-scale privatization and enterprise restructuring. Measuring progress in ***large-scale privatization*** includes assessing the extent of the transfer of assets to the private sector, but also the extent of outside ownership and effective corporate governance of such entities. ***Enterprise restructuring reforms*** address effective corporate governance in large part through government actions to tighten credit and subsidy policy at the firm level, enforce bankruptcy legislation, and break up dominant firms. Such reforms, in other words, provide some of the financial discipline needed for vibrant growth of the private sector.

Not surprisingly, progress towards these reforms has been slower than that of the first round reforms in no small part because they require more preparation to build political consensus as well as to create the infrastructure to implement them. In fact, as highlighted in *Table 2*, it may be that only the Czech Republic, Hungary, and Estonia have progressed sufficiently in these regards, though Slovakia and Poland are not far behind.

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[6] Interest rate liberalization is monitored in EBRD's banking reform indicator.

[7] As of mid-1997, first round reforms still lagged in Bulgaria and Romania, though progress occurred in both in 1996-1997.

Third Round Reforms. These reforms are the most challenging, and progress is least evident in this domain. The focus here is on banking reform, private non-bank financial institutions, competition policy, investment-related legal reforms, and environmental policy. ***Banking reform*** includes progress towards the establishment of bank solvency, well-functioning bank competition coupled with interest rate liberalization, financial deepening and extensiveness of private sector lending, and effective prudential supervision, with movement of laws and regulations towards BIS standards.

Non-bank financial reforms include the development and deepening of securities exchanges, investment funds, private insurance and pensions funds, leasing companies, and associated regulatory framework, with movement of laws and regulations towards IOSCO standards.

The financial system undergirds the market economy. The private sector cannot grow and develop without a sound financial sector. It provides the capital to grow. It provides the discipline towards good corporate governance. Nor can there exist a stable macroeconomic framework without a sound financial system, given its importance in overall monetary management. Moreover, an unstable financial sector can lead to crisis, and, in fact, in many transition economies it has. It starts with the banks, and ripples throughout the economy.

Competition policy focuses on the development of legislation and institutions to facilitate the entry of firms, existing or potential, into existing markets. This includes the promotion of a competitive environment through enforcement actions to reduce the abuse of market power by dominant (or non-competitive) firms. The more competitive is the market structure, the greater is the efficiency of the firm.

Investment-related legal reforms include the development of clear investment or commercial laws which do not discriminate between domestic and foreign investors, and which are well administered and supported judicially. These laws provide much of the rule of law framework so critical for the growth of the private sector.

Finally, ***environmental policy reforms*** include four components: (a) the degree of adherence to six key international environmental treaties; (b) progress in air and water standards; (c) progress in preparing and implementing national environmental action plans; and (d) an assessment of the extent to which environmental financial incentive mechanisms are used. Progress in environmental reforms contributes directly to progress in other economic reform areas.

As highlighted in *Table 3*, perhaps all countries but Hungary, which registered significant gains in financial reforms from mid-1996 to mid-1997, have yet to adequately restructure in this third round set of reforms. Poland and the Czech Republic, however, are not far behind. More generally, the gap between progress in the Northern Tier countries and the other transition economies is greater in these third round economic reforms than is this gap in the first and second round reforms. Of all the economic reforms, competition policy and (second round) enterprise restructuring tend to lag the most throughout CEE and NIS.

Economic Reform Ratings Compared: EBRD vs. Freedom House

Table 4 provides a comparison of EBRD's rating of economic reforms with a similar effort by Freedom House in its *Nations in Transit 1997* (April 1997). Freedom House assesses economic reform by weighing two broad aspects: (1) progress towards privatization and reform of the state sector; and (2) the development of market-economy institutions, with a focus on property rights, a framework for competition, and fiscal, financial, and energy sector reforms.[8]

Three salient observations emerge from the comparison. First, the leaders and laggards in both schemes generally coincide. Hungary, the Czech Republic, Poland, Estonia, and Slovenia are at the top; Turkmenistan, Tajikistan, Belarus, Uzbekistan, and Azerbaijan have the furthest yet to go by both accounts. Second, the gap between the leaders (that is, the Northern Tier countries of CEE except Slovakia) and the rest is greater according to Freedom House. Finally, in contrast to the EBRD findings, Freedom House finds that the Southern Tier countries of CEE lag behind the NIS in economic reforms on balance.

The differences in results may be attributed largely to two reasons. First, the emphases on the kinds of reforms differ some between the two schemes. Freedom House places greater emphasis on privatization. Romania, for example, may score lower and Russia higher because of this. Secondly, and probably more importantly, EBRD's assessment is more current, and hence likely better captures some dramatic and recent turn of events in the Southern Tier CEE in particular--from backsliding in Romania in 1996 and crises in Bulgaria through early 1997 have emerged significant subsequent progress.

Economic Policy Backsliding?

In addition to ascertaining the status or level of the reforms, it is important to examine the trends over time. Are the economic reforms proceeding on track? *Table 5* below shows the change in economic policy reforms from 1994 to August 1997 according to EBRD measures. In sum, only Belarus experienced a net deterioration in economic policy reforms over this four year period.

There have been, however, a number of partial or temporary setbacks in policy reforms. In the past year (mid-1996 to mid-1997), backsliding occurred in Albania in financial reforms, in Uzbekistan in trade and foreign exchange reforms, in Slovakia in trade/foreign exchange and financial reforms, as well as in Belarus in trade and foreign exchange reforms and enterprise restructuring.

[8]Elaboration is given in *Appendix I.*

Progress in economic policy reforms in the past year, nevertheless, has outweighed the backsliding. In fact, sixteen of the twenty-five countries showed progress from mid-1996 to mid-1997. The most broad-based progress was witnessed by Bulgaria, followed by Georgia, Azerbaijan, Russia, Hungary, and Turkmenistan.

Trends over the past year reinforce the tendency for progress in economic reforms to be most evident among those countries at an intermediate stage in the transition process. Progress in countries at a more advanced transition stage has tended to be slower in large part because the remaining reforms among the leaders are the most difficult and take the most time to implement and enforce.

Table 1. First Round Economic Policy Reforms

Country	Small-Scale Privatization	Price Liberalization	Trade & Foreign Exchange	Average
Hungary	5.0	3.3	5.0	4.4
Slovenia	5.0	3.0	5.0	4.3
Poland	5.0	3.0	5.0	4.3
Czech Republic	5.0	3.0	5.0	4.3
Slovakia	5.0	3.0	4.0	4.0
Estonia	5.0	3.0	4.0	4.0
Croatia	5.0	3.0	4.0	4.0
Russia	4.0	3.0	4.0	3.7
Lithuania	4.0	3.0	4.0	3.7
Latvia	4.0	3.0	4.0	3.7
Kyrgyzstan	4.0	3.0	4.0	3.7
Georgia	4.0	3.0	4.0	3.7
FYR Macedonia	4.0	3.0	4.0	3.7
Albania	4.0	3.0	4.0	3.7
Kazakhstan	3.3	3.0	4.0	3.4
Romania	3.0	3.0	4.0	3.3
Moldova	3.0	3.0	4.0	3.3
Bulgaria	3.0	3.0	4.0	3.3
Armenia	3.0	3.0	4.0	3.3
Ukraine	3.3	3.0	3.0	3.1
Azerbaijan	3.0	3.0	2.3	2.8
Uzbekistan	3.0	2.7	1.7	2.4
Tajikistan	2.0	2.7	2.0	2.2
Belarus	2.0	3.0	1.0	2.0
Turkmenistan	2.0	2.0	1.0	1.7
CEE & NIS	**3.8**	**3.0**	**3.7**	**3.5**
Northern Tier CEE	**4.9**	**3.0**	**4.8**	**4.3**
Southern Tier CEE	**3.4**	**3.0**	**4.0**	**3.5**
NIS	**3.6**	**3.0**	**3.4**	**3.3**
Industrial Countries	5.0	5.0	5.0	5.0
Benchmarks	4.0	3.0	4.0	3.7

Note: On a 1 to 5 scale, with 5 being most advanced. All regional averages in this report are population-weighted.

Source: EBRD, *Transition Report 1997* (November 1997).

Table 2. Second Round Economic Policy Reforms

Country	Large-Scale Privatization	Enterprise Restructuring	Average
Czech Republic	4.0	3.0	3.5
Estonia	4.0	3.0	3.5
Hungary	4.0	3.0	3.5
Slovakia	4.0	2.7	3.3
Poland	3.3	3.0	3.2
Slovenia	3.3	2.7	3.0
Croatia	3.0	2.7	2.8
Latvia	3.0	2.7	2.8
Lithuania	3.0	2.7	2.8
Bulgaria	3.0	2.3	2.7
Georgia	3.3	2.0	2.7
Russia	3.3	2.0	2.7
Armenia	3.0	2.0	2.5
FYR Macedonia	3.0	2.0	2.5
Kazakhstan	3.0	2.0	2.5
Kyrgyzstan	3.0	2.0	2.5
Moldova	3.0	2.0	2.5
Romania	2.7	2.0	2.3
Uzbekistan	2.7	2.0	2.3
Ukraine	2.3	2.0	2.2
Albania	2.0	2.0	2.0
Azerbaijan	2.0	2.0	2.0
Turkmenistan	2.0	1.7	1.8
Tajikistan	2.0	1.0	1.5
Belarus	1.0	1.0	1.0
CEE & NIS	**3.0**	**2.1**	**2.6**
Northern Tier CEE	**3.6**	**2.9**	**3.2**
Southern Tier CEE	**2.7**	**2.1**	**2.4**
NIS	**2.9**	**1.9**	**2.4**
Industrial Countries	5.0	5.0	5.0
Benchmarks	4.0	3.0	3.5

Note: On a 1 to 5 scale, with 5 being most advanced.
Source: EBRD, *Transition Report 1997* (November 1997).

Table 3. Third Round Economic Policy Reforms

Country	Competition Policy	Bank Reforms	Non-Bank Fin. Reforms	Legal Reforms	Environ. Policy	Average
Hungary	3.0	4.0	3.3	4.0 (4/4)	4.5	3.8
Poland	3.0	3.0	3.3	4.0 (4/4+)	4.5	3.6
Czech Republic	3.0	3.0	3.0	4.0 (4/4)	4.5	3.5
Estonia	2.7	3.3	3.0	4.0 (4/4)	3.5	3.3
Slovakia	3.0	2.7	2.3	3.0 (3/3)	4.0	3.0
Latvia	2.7	3.0	2.3	3.0 (3+/3)	3.5	2.9
Russia	2.3	2.3	3.0	3.0 (3+/3)	3.5	2.8
Croatia	2.0	2.7	2.3	4.0 (4/4)	3.0	2.8
Lithuania	2.3	3.0	2.3	3.0 (4/3)	3.0	2.7
Slovenia	2.0	3.0	3.0	3.0 (3/4)	2.5	2.7
Romania	2.0	2.7	2.0	3.0 (3/3)	3.5	2.6
Bulgaria	2.0	2.7	2.0	3.0 (3/3)	2.5	2.4
Moldova	2.0	2.0	2.0	2.0 (3/2)	3.0	2.2
Ukraine	2.0	2.0	2.0	2.0 (2/2)	3.0	2.2
Kyrgyzstan	2.0	2.7	2.0	2.0 (3/2)	2.0	2.1
Armenia	2.0	2.3	1.0	3.0 (3/3)	2.0	2.1
Albania	2.0	2.0	1.7	2.0 (2/2)	2.5	2.0
Georgia	2.0	2.3	1.0	2.0 (3/2)	2.5	2.0
Kazakhstan	2.0	2.3	2.0	2.0 (2/2)	1.5	2.0
Belarus	2.0	1.0	2.0	2.0 (2/2)	2.5	1.9
Uzbekistan	2.0	1.7	2.0	2.0 (2+/2)	1.5	1.8
FYR Macedonia	1.0	3.0	1.0	2.0 (2/2)	2.0	1.8
Azerbaijan	1.0	2.0	1.0	1.0 (2+/1)	2.0	1.4
Turkmenistan	1.0	1.0	1.0	... (na/na)	2.0	1.3
Tajikistan	1.0	1.0	1.0	... (na/na)	1.5	1.1
CEE & NIS	**2.2**	**2.4**	**2.5**	**2.8**	**3.2**	**2.6**
Northern Tier CEE	**2.9**	**3.1**	**3.1**	**3.8**	**4.3**	**3.5**
Southern Tier CEE	**2.0**	**2.6**	**2.0**	**3.0**	**3.1**	**2.5**
NIS	**2.1**	**2.1**	**2.4**	**2.5**	**2.9**	**2.4**
Industrial Countries	5.0	5.0	5.0	5.0	5.0	5.0
Benchmarks	4.0	3.0	4.0	4.0	4.0	3.8

Note: On a 1 to 5 scale, with 5 being most advanced. Rating of legal reforms to foster investment is subdivided (in parentheses) into extensiveness and effectiveness.

Source: EBRD, *Transition Report 1997* (November 1997).

Table 4. Economic Policy Reforms: EBRD & Freedom House Ratings Compared

Country	EBRD (November 1997) Rating (1 to 5)	EBRD (November 1997) Ranking	Country	Freedom House (April 1997) Rating (1 to 5)	Freedom House (April 1997) Ranking
Hungary	3.9	1	Hungary	4.6	1
Czech Republic	3.8	2	Czech Republic	4.4	2
Poland	3.7	3	Poland	4.3	3
Estonia	3.5	4	Estonia	4.2	4
Slovakia	3.4	5	Slovenia	4.1	5
Slovenia	3.2	6	Latvia	4.0	6
Croatia	3.2	6	Lithuania	4.0	6
Latvia	3.1	8	Slovakia	3.4	8
Russia	3.0	9	Russia	3.3	9
Lithuania	3.0	9	Kyrgyzstan	3.2	10
Romania	2.8	11	Croatia	3.1	11
Bulgaria	2.7	12	Albania	3.0	12
Kyrgyzstan	2.7	12	Armenia	3.0	12
Georgia	2.6	14	Moldova	3.0	12
Moldova	2.6	14	Georgia	2.9	15
Armenia	2.5	16	Ukraine	2.8	16
Albania	2.5	16	Kazakhstan	2.7	17
Kazakhstan	2.5	16	FYR Macedonia	2.7	18
FYR Macedonia	2.5	16	Romania	2.6	19
Ukraine	2.5	16	Azerbaijan	2.2	20
Uzbekistan	2.1	21	Bulgaria	2.1	21
Azerbaijan	1.9	22	Belarus	1.7	22
Belarus	1.8	23	Tajikistan	1.6	23
Tajikistan	1.6	24	Uzbekistan	1.5	24
Turkmenistan	1.5	25	Turkmenistan	1.4	25
CEE & NIS	**2.9**		CEE & NIS	**3.1**	
Northern Tier CEE	**3.7**		Northern Tier CEE	**4.3**	
Southern Tier CEE	**2.8**		Southern Tier CEE	**2.6**	
NIS	**2.7**		NIS	**2.9**	
EU	**5.0**				

Note: On a 1 to 5 scale, with 5 representing most advanced.

Source: EBRD, *Transition Report 1997* (November 1997), Freedom House, *Nations in Transit 1997* (April 1997).

Table 5. Change in Economic Policy Reforms: 1994-1997

	1st Round			2nd Round		3rd Round				
	1	2	3	4	5	6	7	8	9	Average
Georgia	2.0	0.0	3.0(+)	2.3(+)	1.0	1.0	1.3(+)	0.0	0.0	1.2
Armenia	0.0	0.0	2.0	2.0	1.0	1.0(+)	1.3(+)	0.0	1.0	0.9
Ukraine	1.3(+)	0.0	2.0	1.0	1.0	0.0	1.0	0.0	1.0	0.8
Azerbaijan	2.0(+)	0.0	1.3(+)	1(+)	1.0	0.0	1.0	0.0	1.0	0.8
Kazakhstan	1.3(+)	0.0	2.0	1.0	1.0	0.0	1.3(+)	0.0	0.0	0.7
Latvia	1.0	0.0	0.0	1.0	1.0	0.7(+)	0.0	0.3(+)	2.0	0.7
Moldova	1.0	0.0	2.0	1.0	0.0	0.0	0.0	0.0	1.0	0.6
Albania	1.0	0.0	0.0	1.0	0.0	1.0	0.0	0.7(-)	1.0	0.5
Croatia	1.0	0.0	0.0	0.0	1.0	1.0	0.0	0.3(+)	1.0	0.5
Russia	1.0	0.0	1.0	0.3(+)	0.0	0.3(+)	0.3(+)	1.0	1.0	0.5
Estonia	1.0	0.0	0.0	1.0	0.0	0.0	0.3(+)	1.0(+)	1.0	0.5
Hungary	1.0	0.3(+)	1.0	1.0	0.0	0.0	1.0(+)	0.3(+)	0.0	0.5
Uzbekistan	0.0	0.0	-0.3(-)	1.0	1.0	0.0	1.0	0.0	1.0	0.4
Romania	0.0	0.0	0(+)	1.0	0.0	1.0(+)	1.0	0.0	1.0	0.4
FYR Macedonia	0.0	0.0	0.0	1.0	0.0	0.0	1.0	0.0	1.0	0.3
Slovenia	1.0	0.0	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.3
Lithuania	0.0	0.0	0.0	0.0	1.0	0.3(+)	1.0	0.3(+)	0.0	0.3
Poland	1.0	0.0	1.0	0.3(+)	0.0	0.0	0.0	0.3(+)	0.0	0.3
Bulgaria	1.0	0.0(+)	0.0	1.0(+)	0.3(+)	0.0	0.7(+)	0.0	1.0	0.3
Turkmenistan	1.0(+)	0.0	0.0	1.0(+)	0.7(+)	0.0	0.0	0.0	0.0	0.3
Tajikistan	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	1.0	0.2
Kyrgyzstan	0.0	0.0	1.0	0.0	0.0	0.0	0.7(+)	0.0	0.0	0.2
Czech Republic	1.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
Slovakia	1.0	0.0	0.0(-)	1.0(+)	0.0	0.0	0.0	-0.7(-)	0.0	0.1
Belarus	0.0	0.0	0.0(-)	-1.0	-1.0(-)	0.0	0.0	0.0	-1.0	-0.3
CEE & NIS	0.9(+)	0.0	1.0(+)	0.6	0.3(-)	0.2(+)	0.5(+)	0.4(+)	0.7(+)	0.5
Northern Tier CEE	1.0	0.0	0.8(-)	0.4(+)	0.1	0.0	0.2(+)	0.2(+)	0.1	0.3
Southern Tier CEE	0.4	0.0(+)	0.0(+)	0.9(+)	0.2(+)	0.7(+)	0.7(+)	0.1	1.0	0.4
NIS	1.0(+)	0.0	1.2(-)	0.6	0.4(-)	0.2(+)	0.6(+)	0.5(+)	0.8(+)	0.6
Benchmark										0 or greater

Note: The sub-headings refer to the following economic reforms: (1) small-scale privatization; (2) price liberalization; (3) trade and foreign exchange reforms; (4) large-scale privatization; (5) enterprise restructuring; (6) competition policy; (7) bank reforms; (8) non-bank financial reforms; and (9) legal reforms. The change is based on a rating from 1 to 5, e.g., a "1" represents a policy advancement by a full increment since the previous time period. The figures show a change from 1994 to 1997 for most of the indicators. For price liberalization, competition policy, and non-bank financial reform indicators, the change is over a two year period (1995 to 1997); for legal reforms, a one year period (1995-1996) is shown. A (+) represents an advancement from August 1996 to August 1997, a (-) represents a deterioration during that same period.

Source: EBRD, *Transition Report 1997* (November 1997), and previous editions of the EBRD report.

B. Democratization

Progress towards democracy building is assessed from indicators drawn from Freedom House. First, the status and the change since 1991 in political rights and civil liberties are examined. Second, 1995-1996 democratic trends are further disaggregated and reviewed. As with the economic reforms, sufficient progress must entail both an adequate threshold as well as no significant deterioration.

Political Rights.

Six primary criteria go into the determination of political freedoms:

(a) the extent to which elections for head of government are free and fair;

(b) the extent to which elections for legislative representatives are free and fair;

(c) the ability of voters to endow their freely elected representatives with real power;

(d) the openness of the system to competing political parties;

(e) the freedom of citizens from domination by the military, foreign powers, totalitarian parties, and other powerful groups; and

(f) the extent to which minority groups have reasonable self-determination and self-government.

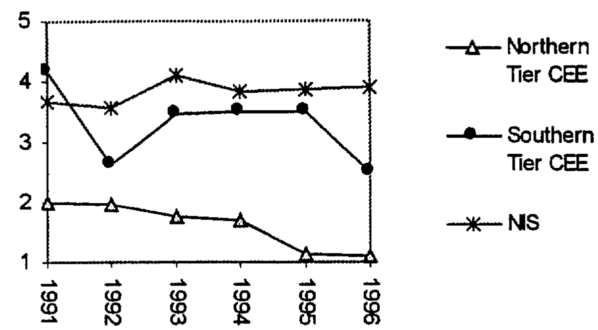
An elaboration of Freedom House's rating scheme of political rights and civil liberties is provided in *Appendix I*.

Greater political liberties are both part of the end objective of a sustainable transition as well as a means to facilitate the economic reforms needed to achieve the transition. Arguably, the most credible route must be one which is facilitated by an open and competitive political system at all levels of government. This system must be sustained by broad-based participation from the electorate, and this electorate must have genuine influence on the course of political events. Such a route may not be the most rapid means of change, but it is by definition the most agreeable means among the citizens and hence likely the most sustainable.

Table 6 and *Figure 2* highlight the results. The results vary widely by country. There are six countries in CEE (the Czech Republic, Hungary, Lithuania, Slovenia, Poland, and Estonia) where political freedoms are among the most advanced in the world; that is, comparable to those found in the industrial market economies. The Czech Republic, Hungary, Lithuania, and Slovenia have maintained this level of freedom since at least 1992 or 1993. Poland achieved this level in 1995, and Estonia in 1996. In scoring the second highest level, four other countries (Bulgaria, Slovakia, Latvia, and Romania) are not far behind.

In contrast, Turkmenistan, Tajikistan, and Uzbekistan were among thirty countries of 191 rated by Freedom House to have the fewest political rights in 1996. Persons of one CEE country (Macedonia) and seven NIS (the above-mentioned three plus Kyrgyzstan, Belarus, Kazakhstan, and Azerbaijan) witnessed a deterioration in political rights from 1991 to 1996. During 1996, political rights decreased in Albania and Armenia, as well as in Belarus.

Figure 2: Political Rights–Regional Averages



Note: On a scale from 1(most free) to 7 (least free).
Source: Freedom House, *Nations in Transit 1997* (April 1997).

Finally, progress in the development of political rights over the transition through 1996 is most evident in Romania, Moldova, and Georgia. During 1996, political rights increased in two of these countries, Romania and Moldova, as well as in Estonia.

Civil Liberties.

Ten primary criteria go into the determination of civil liberties:

(a) freedom of media, literature, and other cultural expressions;

(b) existence of open public discussion and free private discussion including religious expressions;

(c) freedom of assembly and demonstration;

(d) freedom of political or quasi-political organization (which includes political parties, civic associations, and ad hoc issue groups);

(e) equality of citizens under law with access to independent, nondiscriminatory judiciary;

(f) protection from political terror and freedom from war or insurgency situations;

(g) existence of free trade unions, professional organizations, businesses or cooperatives, and religious institutions;

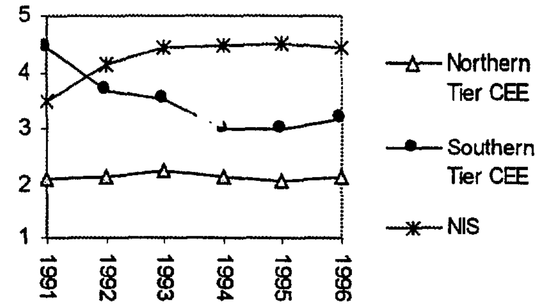
(h) existence of personal social freedoms, which include gender equality, property rights, freedom of movement, choice of residence, and choice of marriage and size of family;

(i) equality of opportunity; and

(j) freedom from extreme government indifference and corruption.

Civil liberties are the freedoms to develop views, institutions, and personal autonomy apart from the state. The development of civil liberties, like political liberties, is an end objective in itself. The merits of such liberties as freedom of assembly and open public discussions, and freedom from political terror and war are self-evident.

Figure 3: Civil Liberties--Regional Averages



Note: On a scale from 1 (most free) to 7 (least free).
Source: Freedom House, *Nations in Transit* (April 1997).

However, greater civil liberties can also serve as a crucial counterweight or check on governments in societies where political rights are lacking. This counterweight can be found among NGOs (such as free trade unions, professional organizations, and religious institutions) as well as a free media. An independent, nondiscriminatory judiciary is critical for similar reasons.

In addition, civil liberties tend to link quite closely with economic progress. Many—such as greater equality of opportunity, freedom from corruption, the existence of personal social freedoms such as gender equality, property rights, freedom of movement—contribute to a more productive economy as well as a more just one.

Table 7 and *Figure 3* highlight the results. As with political liberties, results vary widely. Seven countries of CEE (the Czech Republic, Poland, Slovenia, Hungary, Estonia, Latvia, and Lithuania) have civil liberties comparable to several industrial market economies, including France, Germany, Italy, and the UK. Five of these countries (the Czech Republic, Poland, Slovenia, Hungary, and Estonia) have maintained this threshold since at least 1993. Of the seven, only Latvia showed a relapse, albeit temporary, in civil liberties from 1991-1996. Two CEE countries, Bulgaria and Slovakia, experienced a decrease in civil liberties in 1996; no CEE countries witnessed an increase.

To contrast, civil liberties deteriorated in seven NIS from 1991-1996. Two NIS, Turkmenistan and Tajikistan, are rated by Freedom House as having civil liberties in 1996 as few as any country in the world. Nevertheless, not all recent trends in civil liberties in the NIS are so dismal. In 1996, civil liberties increased in Georgia, Azerbaijan, and Uzbekistan; only Belarus of the NIS saw a deterioration in civil liberties in 1996.

Democratization Disaggregated.

In its *Nations in Transit 1997*, Freedom House further disaggregated democratization trends in the region. *Table 8* displays this effort. Five components of democracy building are rated on a one-to-seven scale in each country for 1996 and compared to progress in 1995.

The ***political process*** focuses on elections, party configuration, political competition, and popular participation in elections. ***Civil society*** assesses the status of nongovernmental organizations; the number and nature of NGOs, and the degree of participation. ***Independent media*** attempts to measure freedom from government control (such as legal protection, editorial independence, and the extent of privatization) and the financial viability of private media. ***Rule of law*** examines constitutional reforms, the development and independence of the judiciary, and the rights of ethnic minorities. ***Governance and Public Administration*** focuses on legislative and executive effectiveness, and on government decentralization, including the independence and effectiveness of local and regional government.[9]

The results of Freedom House's attempts to quantify these five components of political liberalism are not directly comparable with the more aggregate ratings of political rights and civil liberties by Freedom House. Emphases differ some between the two schemes since the more aggregate measures are applied worldwide, while the disaggregated components may be better tailored to the ENI context.

Still, broad trends coincide; the relative progress between countries is similar between the two schemes. One difference that does emerge, however, is that a gap between the Northern Tier countries (particularly with the exclusion of Slovakia) and the rest is more evident in the disaggregated scheme.

In general, democratic freedoms are most advanced in political processes and least advanced in government and public administration. Armenia is the salient exception to the first generalization, and Kyrgyzstan to the second.

There were more countries which witnessed an increase in democratic freedoms (nine countries) in 1996 than there were those which showed deterioration (five). Democratization deteriorated across the board for Belarus; that is, in all five components. Croatia saw deterioration in three aspects. Of those which advanced, only Poland and Georgia witnessed an increase in more than one sector. No countries witnessed advance in one area and retrogression in another.

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[9]Elaboration of the five components is provided in *Appendix I.*

Table 6. Political Rights[1]

Country	1993	1994	1995	1996	1993-1996 Change[2]	1991-1996 Change[3]
Czech Republic	1	1	1	1	0	...
Estonia	3	3	2	1	+ 2	+ 1
Hungary	1	1	1	1	0	+ 1
Lithuania	1	1	1	1	0	+ 1
Poland	2	2	1	1	+ 1	+ 1
Slovenia	1	1	1	1	0	0
Bulgaria	2	2	2	2	0	0
Latvia	3	3	2	2	+ 1	0
Romania	4	4	4	2	+ 2	+ 3
Slovakia	3	2	2	2	+ 1	...
Moldova	5	4	4	3	+ 2	+ 2
Russia	3	3	3	3	0	0
Ukraine	4	3	3	3	+ 1	0
Albania	3	3	3	4	- 1	0
Croatia	4	4	4	4	0	0
FYR Macedonia	3	4	4	4	- 1	- 1
Georgia	5	5	4	4	+ 1	+ 2
Kyrgyzstan	5	4	4	4	+ 1	- 1
Armenia	3	3	4	5	- 2	0
Azerbaijan	6	6	6	6	0	- 1
Belarus	5	4	5	6	- 1	- 2
Kazakhstan	6	6	6	6	0	- 1
Tajikistan	7	7	7	7	0	- 2
Turkmenistan	7	7	7	7	0	- 1
Uzbekistan	7	7	7	7	0	- 1

Region	1993	1994	1995	1996	1993-1996 Change	1991-1996 Change
CEE & NIS	**3.6**	**3.4**	**3.3**	**3.2**	**+ 0.4**	**+ 0.2**
Northern Tier CEE	**1.8**	**1.7**	**1.1**	**1.1**	**+ 0.7**	**+ 0.9**
Southern Tier CEE	**3.5**	**3.5**	**3.5**	**2.5**	**+ 1.0**	**+ 1.7**
NIS	**4.1**	**3.8**	**3.9**	**3.9**	**+ 0.2**	**- 0.2**
European Union[4]				1.0		
OECD[5]				1.2		
Benchmarks				1.0	0	

Notes: [1]Ratings range from 1 to 7, with 1 representing greatest development of political rights. [2]A "+" refers to an increase in freedom. [3]The change for Slovenia, FYR Macedonia, and Croatia is calculated from 1992 to 1996. [4]All 15 EU members score "1". [5]All but three OECD members score a "1"; the exceptions are Turkey ("4"), Mexico ("4"), and Korea ("2").

Source: Freedom House, *Nations in Transit 1997* (April 1997).

Table 7. Civil Liberties[1]

Country	1993	1994	1995	1996	1993-1996 Change[2]	1991-1996 Change[3]
Czech Republic	2	2	2	2	0	...
Estonia	2	2	2	2	0	+ 1
Hungary	2	2	2	2	0	0
Latvia	3	2	2	2	+ 1	0
Lithuania	3	3	2	2	+ 1	+ 1
Poland	2	2	2	2	0	0
Slovenia	2	2	2	2	0	0
Bulgaria	2	2	2	3	- 1	0
FYR Macedonia	3	3	3	3	0	0
Romania	4	3	3	3	+ 1	+ 2
Albania	4	4	4	4	0	0
Armenia	4	4	4	4	0	+ 1
Croatia	4	4	4	4	0	0
Georgia	5	5	5	4	+ 1	+ 1
Kyrgyzstan	3	3	4	4	- 1	0
Moldova	5	4	4	4	+ 1	0
Russia	4	4	4	4	0	- 1
Slovakia	4	3	3	4	0	...
Ukraine	4	4	4	4	0	- 1
Azerbaijan	6	6	6	5	+ 1	0
Kazakhstan	4	5	5	5	- 1	- 1
Belarus	4	4	5	6	- 2	- 2
Uzbekistan	7	7	7	6	+ 1	- 1
Tajikistan	7	7	7	7	0	- 2
Turkmenistan	7	7	7	7	0	- 2
Region	**1993**	**1994**	**1995**	**1996**	**1993-1996 Change**	**1991-1996 Change**
CEE & NIS	**3.9**	**3.9**	**3.9**	**3.9**	**0.0**	**- 0.5**
Northern Tier CEE	**2.2**	**2.1**	**2.1**	**2.1**	**+ 0.1**	**- 0.1**
Southern Tier CEE	**3.5**	**3.0**	**3.0**	**3.2**	**+ 0.3**	**+ 1.2**
NIS	**4.4**	**4.5**	**4.5**	**4.4**	**0.0**	**- 1.0**
European Union[4]				1.5		
OECD[5]				1.7		
Benchmarks				2.0	0.0	

Note: [1]The ratings range from 1 to 7, with 1 representing the most advanced. [2]A "+" refers to an increase in civil liberties. [3]The change for Slovenia, FYR Macedonia, and Croatia is calculated from 1992 to 1996 [4]8 of the 15 members score a "1"; 6 score a "2" (Belgium, France, Germany, Italy, Spain and the UK); and Greece scores a "3". [5]15 members score a "1"; 11 score a "2" (Belgium, Czech Republic, France, Hungary, Italy, Germany, Japan, Korea, Poland, Spain, and the UK); Greece and Mexico score a "3"; Turkey scores a "5".

Source: Freedom House, *Nations in Transit 1997* (April 1997).

Table 8. Democratization Disaggregated

Country	Political Process	Civil Society	Independent Media	Rule of Law	Govt/Public Administration	Average
Czech Republic	1.3 (+)	1.5	1.3	1.5	2.0	1.5
Poland	1.5	1.3	1.5 (+)	1.5 (+)	1.8	1.5
Hungary	1.3	1.3	1.5	1.8	1.8	1.5
Slovenia	2.0	2.0	1.8	1.8	2.5	2.0
Estonia	2.0	2.3	1.8	2.3	2.3	2.1
Latvia	2.0	2.3	1.8	2.3	2.5	2.2
Lithuania	2.0	2.3	1.8	2.3	2.5	2.2
Russia	3.5	3.8	3.8	4.0 (+)	4.0	3.8
Slovakia	3.8	3.3	4.3 (+)	4.0	3.8	3.8
FYR Macedonia	3.5	3.8	4.0	4.3	4.0 (+)	3.9
Bulgaria	3.3	4.0	3.8	4.3	4.3	3.9
Moldova	3.3	3.8	4.0 (+)	4.3	4.3	3.9
Romania	3.3 (+)	3.8	4.3	4.3	4.3	4.0
Ukraine	3.3	4.0	4.5	3.8 (+)	4.5	4.0
Croatia	4.0 (-)	3.5	4.8 (-)	4.8	4.0 (-)	4.2
Albania	4.3 (-)	4.3	4.8 (-)	4.8	4.8	4.6
Kyrgyzstan	5.0	4.5	5.0	4.5	4.3	4.7
Georgia	5.0 (+)	4.5	4.5	5.0 (+)	4.5	4.7
Armenia	5.5 (-)	3.5	5.3 (-)	4.8	4.5	4.7
Kazakhstan	5.5 (-)	5.3	5.3	5.0	5.5	5.3
Azerbaijan	5.8	5.0	5.5	5.5	6.3	5.6
Belarus	6.0 (-)	5.3 (-)	6.3 (-)	6.0 (-)	6.0 (-)	5.9
Tajikistan	6.0	5.5	6.3	6.3	7.0	6.2
Uzbekistan	6.3	6.5	6.5	6.5	6.0	6.4
Turkmenistan	7.0	7.0	7.0	6.8	6.8	6.9

	Political Process	Civil Society	Independent Media	Rule of Law	Govt/Public Administration	Average
CEE & NIS	3.6	3.8	4.0	4.0	4.1	3.9
Northern Tier CEE	1.7	1.6	1.7	1.8	2.1	1.8
Southern Tier CEE	3.5	3.8	4.3	4.4	4.3	4.1
NIS	4.1	4.3	4.5	4.5	4.6	4.4

Note: On a scale from 1 to 7, with 1 representing most free. A "+" indicates an increase in democratization since 1995; a "-" signifies a decrease.

Source: Freedom House, *Nations in Transit 1997* (April 1997).

C. Summary of Economic Reforms & Democratization

Table 9 provides a summary picture of the status of the economic policy reforms and democratic freedoms. The economic policy reform ratings represent an average of all ten EBRD policy indicators (that is, all three rounds). The democratic freedom ratings incorporate Freedom House's rating of political rights and civil liberties. For uniformity, Freedom House's ratings have been compressed to a one-to-five scale with five representing the most free. *Figure 4* portrays these data in part to help ascertain how and to what extent economic policy and democratic reforms might be linked.

Salient observations.

As revealed in *Figure 4*, there seem to be three groups of countries differentiated by progress towards economic and democratic reforms. The Northern Tier countries, less Slovakia, consist of one group, and are substantially out front, particularly in democratic reforms. The laggards appear to consist of six countries: the Central Asian Republics (less Kyrgyzstan), Belarus, and Azerbaijan. The middle group is the largest and includes the Southern Tier CEE countries, Russia, Ukraine, and other NIS. In general, this middle group may be where U.S. foreign assistance can realize the greatest return on its investment; where needs are great, and the quality of partnership (with exceptions) is relatively high.

The spread in progress between the three groups is more evident in democratization than it is in economic reforms. Six of the Northern Tier countries now have democratic standards roughly comparable to many Western democracies. Two Central Asian Republics rank among the least democratic worldwide.

Linked to this trend is the observation that economic policy reforms in the region, relative to the standards in the industrial market economies, have far to go, even in the Northern Tier countries.

Figure 4 also reveals a close correspondence between economic and political liberalism. The trend line highlights that progress in both reform areas tend to go hand-in-hand. Progress in both areas is the most advanced in Hungary, the Czech Republic, and Poland. Turkmenistan, Tajikistan, Azerbaijan, Belarus, and Uzbekistan, rank towards the bottom in both areas.

There may be some notable exceptions. Croatia and Slovakia have advanced relatively more in economic reforms than in democracy. Croatia, for example, ranks sixth in economic reforms, but only fifteenth in democratization. In contrast, Lithuania, Macedonia, and Ukraine have advanced relatively more in democratization than in economic reforms. Lithuania, for example, ranks among the leaders in democratic reforms, but ranks ninth, alongside Russia, in economic reforms.

Table 9. Economic Policy Reforms and Democratic Freedoms in CEE & The NIS

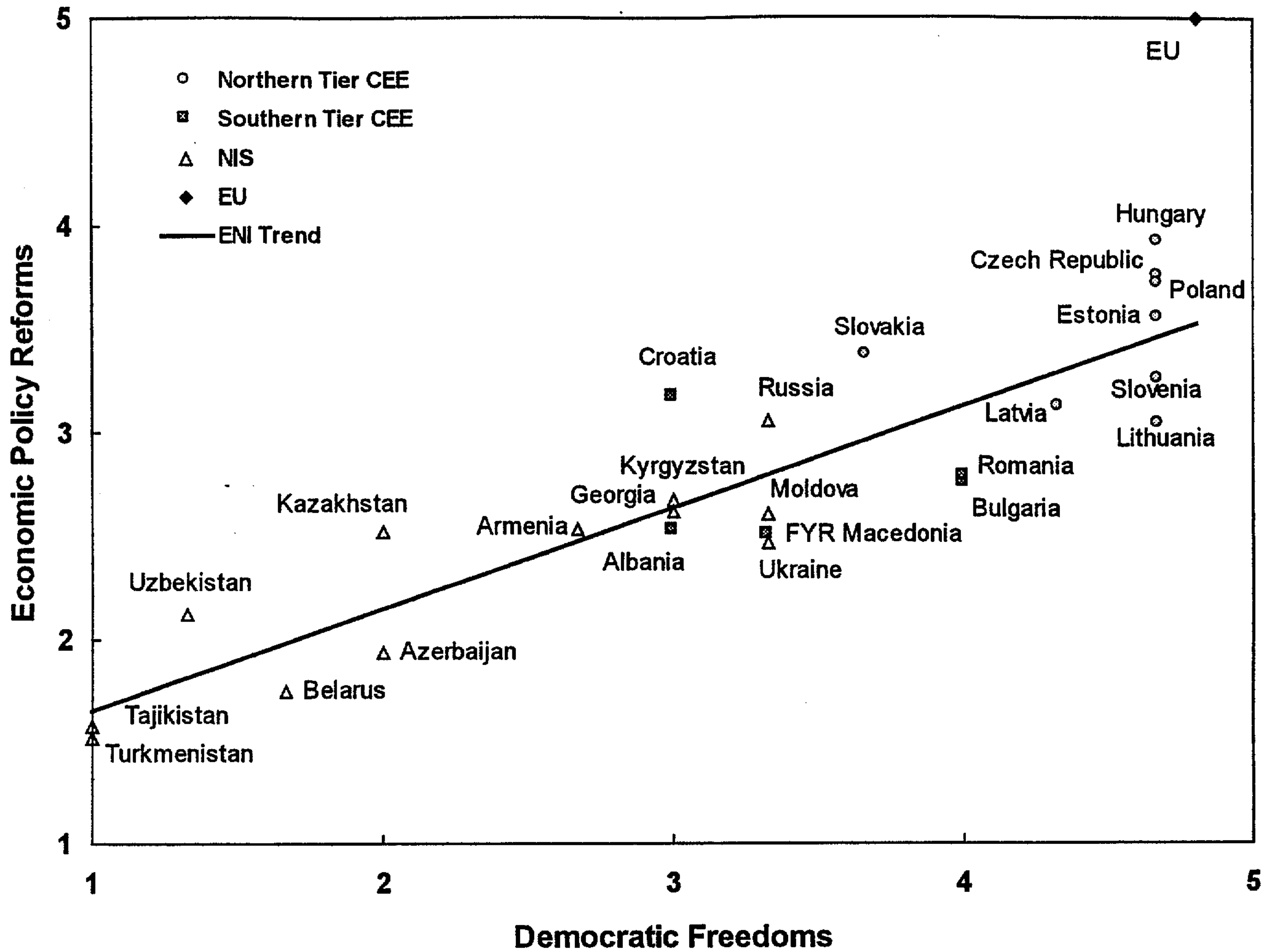
Economic Policy			Democratic Freedoms		
Country	Rating (1 to 5)	Ranking	Country	Rating (1 to 5)	Ranking
Hungary	3.9	1	Hungary	4.7	1
Czech Republic	3.8	2	Czech Republic	4.7	1
Poland	3.7	3	Poland	4.7	1
Estonia	3.5	4	Estonia	4.7	1
Slovakia	3.4	5	Lithuania	4.7	1
Slovenia	3.2	6	Slovenia	4.7	1
Croatia	3.2	6	Latvia	4.3	7
Latvia	3.1	8	Bulgaria	4.0	8
Russia	3.0	9	Romania	4.0	8
Lithuania	3.0	9	Slovakia	3.7	10
Romania	2.8	11	FYR Macedonia	3.3	11
Bulgaria	2.7	12	Moldova	3.3	11
Kyrgyzstan	2.7	12	Russia	3.3	11
Georgia	2.6	14	Ukraine	3.3	11
Moldova	2.6	14	Albania	3.0	15
Armenia	2.5	16	Croatia	3.0	15
Albania	2.5	16	Georgia	3.0	15
Kazakhstan	2.5	16	Kyrgyzstan	3.0	15
FYR Macedonia	2.5	16	Armenia	2.7	19
Ukraine	2.5	16	Azerbaijan	2.0	20
Uzbekistan	2.1	21	Kazakhstan	2.0	21
Azerbaijan	1.9	22	Belarus	1.7	22
Belarus	1.8	23	Uzbekistan	1.3	23
Tajikistan	1.6	24	Tajikistan	1.0	24
Turkmenistan	1.5	25	Turkmenistan	1.0	24

Regional Averages	Economic Policy Rating (1 to 5)	Democratic Freedoms Rating (1 to 5)
CEE & NIS	2.9	3.3
Northern Tier, CEE	3.7	4.6
Southern Tier, CEE	2.8	3.8
NIS	2.7	2.9
European Union	5.0	4.8
OECD	--	4.6

Note: Ratings are on a 1 to 5 scale, with 5 representing most advanced. Bosnia Herzegovina rates a "2.1" on democratic freedoms, Yugoslavia (Serbia & Montenegro), a "1.4".

Source: Economic Policy ratings are from EBRD, *Transition Report 1997* (November 1997); democracy ratings are from Freedom House, *Nations in Transit 1997* (April 1997) and *Freedom in the World 1996-1997* (1997).

Figure 4: Economic Policy Reforms and Democratic Freedoms in CEE and the NIS



Note: Ratings based on 1 to 5 scale, with 5 representing most advanced.
Source: EBRD, *Transition Report 1997* (November 1997), Freedom House, *Nations in Transit 1997*

D. Sustainability

In this section, we weigh the economic and democratic reforms with the macroeconomic and microeconomic evidence. Economic policy reforms need to translate into good macroeconomic performance. Yet, this is not enough. The benefits at the macro level must also be reasonably well distributed and need to translate into social conditions that at the least are not significantly deteriorating. Otherwise, the reforms may stall for lack of support, and/or fiscal sustainability may be jeopardized.

It merits stating that the quality of these data is often questionable. Credible comparisons across time and across countries are sometimes difficult. In general, data for CEE are better than that for the NIS, and much of the economic data are likely better than much of the social data. Conclusions should be based on a variety of evidence if possible.

1. Macroeconomic Performance.

Tables 10 through *16* highlight macroeconomic performance. Fundamental to sustaining reforms is sustained **economic growth** at some moderate rate or greater. As evident in *Table 10*, the Northern Tier countries are achieving this. This sub-region overall in fact has been growing at a very impressive clip; nearly five percent on average over the past three years and more than double the EU rate. The best performers among this group are Poland, Slovakia, and Estonia; the worst performer in 1997—at 1% growth—was the Czech Republic.

In contrast, the robust economic growth in Southern Tier CEE in 1994-1995 has given way to contraction overall in 1997. Albania's economy contracted by fifteen percent in 1997, and Romania's economy by almost two percent. Bulgaria's economy contracted by nearly eleven percent in 1996 and seven percent in 1997.

For the NIS, 1997 looks to be the first year of positive economic growth on average since the transition began. This is largely because Russia's economy likely registered its first expansion in 1997 since communism's collapse; perhaps growing by one percent. Still, while the majority of the NIS experienced positive economic growth in 1997, only three—Georgia, Armenia, and Kyrgyzstan—have experienced robust, sustained (three years or more) growth during the transition.

Inflation continues to fall for most of the countries in Northern Tier CEE and the NIS (*Table 11*). The drop in inflation is particularly impressive in the NIS where 1997 inflation is close to twenty percent, down from almost 200 percent in 1995.

Still, inflation is too high in most countries. Annual inflation rates much above the single-digit range erodes business confidence, and the ability and incentive to invest and expand at the enterprise level. Only six countries, all in CEE (Croatia, Macedonia, Slovakia, the Czech Republic, Slovenia, and Latvia), had a 1995-1997 inflation rate below fifteen percent. By comparison, EU inflation in recent years has remained below three percent.

Moreover, several countries have witnessed significant increases in inflation. In Southern Tier CEE, inflation has increased significantly since 1995 in Albania, Bulgaria, and Romania. In the NIS, Belarus and Tajikistan experienced a resurgence in inflation in 1997.

Budget deficits (*Table 12*) that remain high fuel inflation and unproductive activity, particularly if financial markets are not well-functioning. If in fact the financial markets are well-established, high budget deficits may ultimately crowd out potential private sector investors from such markets.

While the deficits on average in ENI have declined substantially since the beginning of the transition, there was notable backsliding in 1996 which largely continued in 1997. In fact, of the twenty countries for which 1997 data are available, eleven showed deterioration in the fiscal balance in 1997. Russia's fiscal deficit of eight percent of GDP in 1997 is highest.

Nevertheless, there may be as many as ten countries with 1994-1996 fiscal balances which equal or better the EU Maastricht target of a three percent deficit. Five are Northern Tier countries.

Table 13 shows trends in **domestic investment** and the share of the economies in private sector hands. The **private sector share of the economy** is a good proxy for the extent of economic restructuring, either through the privatization process or the growth of new private-sector firms. Those economies which predominantly produce private sector output are much more likely to generate momentum towards greater economic expansion overall.

Nineteen countries of the region now in fact have a private sector generating at least fifty percent of GDP. The average for all of CEE and NIS is sixty percent. This represents very impressive gains; in 1989, the region's private sector share was probably closer to ten percent of GDP.

OECD economies have private sectors which range from seventy to eighty-five percent of GDP. Seven transition countries (six Northern Tier countries, Russia, and Albania) now have private sectors that meet this threshold. In contrast, six countries (all NIS) still have economies in which more than fifty percent of economic activity derives from the public sector.

Domestic investment (*Table 13*) contributes to the productive capacity of the economy and hence helps provide the momentum which is necessary for sustained economic expansion further down the road. Domestic investment in the region on average is roughly twenty-two percent of GDP.[10]

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[10]This combines public and private investment. A more revealing indicator would measure private domestic investment only.

This is above the EU and OECD averages, though it falls far short of investment rates generated in the high-performing Asian developing economies.

According to the data, some economies are investing very little. In particular, Georgia, Moldova, and Armenia are all devoting less than ten percent of their GDP toward investment.

Paralleling GDP trends, most countries have experienced a significant decline in investment since 1990; a roughly twenty-five percent drop for the region as a whole. However, this trend may be changing, at least for the Northern Tier countries. The 1994-1995 data suggest resumption of investment growth for at least seven countries, and six of these are Northern Tier countries.

An important indicator of the extent to which firms are restructuring is the **productivity of labor**, or output per employee (*Table 14*). The efficiency gains from an increase in productivity would likely stem from a number of possibilities, including fewer excess workers, greater skilled and/or motivated workers, improved capital stock, and/or a greater capacity to manage.

Labor productivity in industry is increasing in the CEE countries for which data are available. Productivity growth has been high (over ten percent annually on average) in Hungary and Poland since 1992. Productivity gains have also been impressive in Romania, Slovenia, and the Czech Republic over the medium term, though productivity growth in the Czech Republic has recently slowed considerably. At least four CEE countries (Hungary, Poland, Bulgaria, and Slovenia) now have regained pre-transition levels of productivity.

Very little productivity data are available for the NIS. Productivity in industry in Russia resumed growth in 1995 and has likely continued through 1997.

How and to what extent these economies integrate into the world economy play significantly into the type of the transition path and its sustainability. *Tables 15 and 16* highlight some key aspects of this integration: export growth and openness to trade; current account balances; institutional integration; foreign direct investment; and external debt.

The gains from trade can be substantial, and range from the tangible (of increasing an economy's quantity and quality of available goods, including capital goods) to the intangible (of providing incentives and a constituency to maintain the market-based reforms which also serve as pre-requisites to institutional integration with the industrial market economies).

Export growth through the region on balance is very high, almost twenty percent from 1994-1996. It is highest in the Northern Tier countries, but the other subregions are close behind. To contrast, for the EU, it was closer to seven percent during this period.

Still, the averages mask wide diversity. Exports may have contracted, in fact, in Macedonia, Georgia, and Turkmenistan from 1994-1996.

Openness to trade or outward-orientation varies widely throughout ENI. This is a reflection in part of the fact that such an indicator is influenced by a handful of factors, including the competitiveness of the economy as well as its size (the smaller economies tend to be more outward-oriented out of necessity).

Outward-orientation is greater in the ENI region than it is in the EU and in the advanced economies more broadly. Within ENI, the sub-region with the greatest outward-orientation is the Northern Tier; the external sector (exports and imports) is roughly at least as large as the entire economy in Estonia, the Czech Republic, Slovakia, Latvia, and Slovenia. If the data are credible, however, Turkmenistan and Tajikistan are far and away the most outward-oriented of all the transition economies; exports and imports in these economies may have been more than 300 percent of GDP in 1996.

Most ENI countries are incurring **current account deficits** (*Table 15*). To some extent, as the economies climb out of the "transition trough," current account deficits can be expected, and may even be a reflection of positive developments. Some of the transition leaders in CEE in fact registered sharp deteriorations in current account deficits in 1995 and 1996 due largely to robust economic growth (and presumably not because of any significant decline in export competitiveness). Further, if much of the imports are capital goods, as seems to be the recent case, for example, in the Czech Republic, then this may contribute to a greater ability to compete and export in the future.

Nevertheless, high current account deficits cannot be sustained over the longer-term without adverse consequences. This concern applies to a number of countries. In CEE, Albania, Macedonia, and Estonia have all been incurring high current account deficits over several years. Hungary's deficit has been high as well, though it improved significantly in 1996. Current account deficits mushroomed in the Czech Republic, Slovakia, and Croatia in 1996.

Among the NIS, current account deficits are even higher in some countries: thirty percent of GDP from 1994-1996 in Armenia; twenty percent of GDP in Georgia and Kyrgyzstan; and fifteen percent in Azerbaijan.

An important means to institutionalizing global integration, and hence to locking-in the gains from reform, is through memberships and/or **participation in international organizations.** For our purposes, this includes membership or participation towards membership in the OECD, the World Trade Organization, NATO, and the European Union. As shown in *Table 15*, institutional integration, as so defined, is taking place only among the CEE countries, and primarily in the Northern Tier. The Czech Republic, Hungary, and Poland have recently been invited to join NATO. In addition, these three countries plus Slovenia and Estonia have been invited to participate in the next round of negotiations towards EU membership.

Foreign direct investment (FDI) is key to the transition (*Table 16*). It helps meet the substantial fixed investment needs of the region that arise from obsolete fixed capital stocks and inadequate infrastructure. It does so without adding to the external debt burden. And, it brings with it some very important externalities, including access to advanced technology and export markets, and exposure to advanced management and marketing techniques.

For most of the countries, foreign direct investment (FDI) flows remain relatively insignificant, and the potential to attract such investment largely unrealized. The cumulative inflow during 1991-1996 may be close to four percent of the transition economies' GDP. This compares to six percent for Latin America and thirteen percent for the East Asian developing economies.

The lion's share of FDI in ENI is going to a handful of Northern Tier countries. Close to one-half of the cumulative flows during 1991-1996, in fact, have gone to Hungary and the Czech Republic. On a per capita basis, Hungary has attracted far and away the greatest amount. The Czech Republic is a distant second, followed by Estonia and Slovenia.

Much of the FDI in CEE has been tied to the privatization process, and most of it so far is inward-looking; that is, to produce or service for the domestic market. The relatively small amount of FDI that has flowed to the NIS has largely been in response to opportunities to exploit energy resources, in Turkmenistan, Azerbaijan, and Kazakhstan in particular.

Many transition economies have made considerable progress towards gaining access to international financial markets. Such access means greater financial capital, expertise, and financial discipline. Important pre-requisites to such access include significant progress towards economic reforms and a sustainable external debt position.

External debt trends vary widely in the region (*Table 16*). By World Bank standards, two countries in 1996—Albania and Georgia—were severely indebted, and four—Armenia, Bulgaria, Hungary, and Kyrgyzstan—were moderately indebted.[11] The high indebtedness among some in the NIS is striking given that Russia assumed all the Soviet debt at the outset of the transition. In addition to the three NIS mentioned above, debt is relatively high for Moldova as well as Russia, at levels just under the moderately indebted threshold.

In CEE, much progress has been made in reducing debt burdens since 1991. This includes progress in the relatively more indebted countries of Albania and Bulgaria. Hungary has made good progress as well since 1994, though its debt service burden (at fifty percent of exports) remains too high and much above all other countries but Tajikistan. Poland and Croatia have also considerably decreased their debt burden.

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[11]The World Bank classifies a country as "severely indebted" if its debt-export ratio exceeds 220 percent, and "moderately indebted" if debts are more than 132 percent of exports.

Table 10. Growth in Real GDP (%)

Country	1990	1991	1992	1993	1994	1995	1996	1997 (est)	1995-1997 average
Georgia	-12.4	-13.8	-44.8	-25.4	-11.4	2.4	10.5	10.5	**7.8**
Armenia	-7.4	-17.1	-52.6	-14.8	5.4	6.9	5.8	5.8	**6.2**
Poland	-11.6	-7.0	2.6	3.8	5.2	7.0	6.0	5.5	**6.2**
Slovakia	-2.5	-14.6	-6.5	-3.7	4.9	6.8	6.9	4.5	**6.1**
Estonia	-8.1	-7.9	-14.2	-8.5	-1.8	4.3	4.0	7.0	**5.1**
Kyrgyzstan	3.0	-5.0	-19.0	-16.0	-20.0	1.3	5.6	6.0	**4.3**
Slovenia	-4.7	-8.9	-5.5	2.8	5.3	[illegible]	3.1	4.0	**3.7**
Lithuania	-5.0	-13.4	-37.7	-24.2	1.0	3.0	3.6	4.5	**3.7**
Czech Republic	-1.2	-11.5	-3.3	0.6	2.7	5.9	4.1	1.0	**3.7**
Croatia	-6.9	-19.8	-11.1	-0.9	0.6	1.7	4.2	5.0	**3.6**
Romania	-5.6	-12.9	-8.7	1.5	3.9	7.1	4.1	-1.5	**3.2**
Hungary	-3.5	-11.9	-3.1	-0.6	2.9	1.5	1.0	3.0	**1.8**
Latvia	2.9	-10.4	-34.9	-14.9	0.6	-0.8	2.8	3.4	**1.8**
Albania	-10.0	-27.7	-7.2	9.6	9.4	8.9	8.2	-15.0	**0.7**
FYR Macedonia	-9.9	-12.1	-21.1	-8.4	-4.0	-1.4	1.1	2.0	**0.6**
Uzbekistan	1.6	-0.5	-11.1	-2.3	-4.2	-0.9	1.6	1.0	**0.6**
Azerbaijan	-11.7	-0.7	-22.6	-23.1	-18.1	-11.0	1.3	5.2	**-1.5**
Belarus	-3.0	-1.2	-9.6	-7.6	-12.6	-10.4	2.6	3.0	**-1.6**
Kazakhstan	-0.4	-13.0	-2.9	-10.4	-17.8	-8.9	1.1	2.0	**-1.9**
Russia	-4.0	-5.0	-14.5	-8.7	-12.6	-4.0	-5.0	1.0	**-2.7**
Moldova	-2.4	-17.5	-29.0	-1.0	-31.2	-3.0	-8.0	-2.0	**-4.3**
Bulgaria	-9.1	-11.7	-7.3	-2.4	1.8	2.1	-10.9	-7.0	**-5.3**
Tajikistan	-1.6	-7.1	-29.0	-11.1	-21.5	-12.5	-7.0	-3.0	**-7.5**
Ukraine	-3.4	-11.6	-13.7	-14.2	-23.0	-11.8	-10.1	-3.0	**-8.3**
Turkmenistan	2.0	-4.7	-5.3	-10.0	-19.0	-8.2	-3.0	-15.0	**-8.7**

Regional Averages	1990	1991	1992	1993	1994	1995	1996	1997 (est)	1995-1997 average
CEE & NIS	**-4.4**	**-7.9**	**-12.2**	**-7.1**	**-9.4**	[illegible]	**-1.9**	**0.9**	**-1.2**
Northern Tier CEE	**-7.3**	**-9.3**	**-3.4**	**0.0**	**4.0**	**5.5**	**4.8**	**4.3**	**4.9**
Southern Tier CEE	**-7.0**	**-14.6**	**-9.2**	**0.6**	**3.2**	**5.2**	**1.2**	**-2.8**	**1.2**
NIS	**-3.3**	**-6.6**	**-14.9**	**-10.0**	**-14.7**	**-5.7**	**-4.0**	**0.5**	**-3.1**
European Union	**3.0**	**1.6**	**1.0**	**-0.5**	**3.0**	**2.5**	**1.7**	**2.5**	**2.2**
Advanced Countries	**2.7**	**1.2**	**1.9**	**1.2**	**3.2**	**2.5**	**2.7**	**3.0**	**2.7**
Developing Countries	**4.1**	**4.9**	**6.6**	**6.6**	**6.8**	**6.0**	**6.5**	**6.2**	**6.2**
Benchmarks	**(a) 3 years positive growth, (b) 3 year average growth rate of 2.0% or more**								

Source: EBRD, *Transition Report 1997* (November 1997), IMF, *World Economic Outlook* (October 1997)

Table 11. Inflation (annual percent)

Country	1991	1992	1993	1994	1995	1996	1997 (est)	Average 1996-1997	Average 1995-1997
Croatia	250	938	1149	-3	4	3	4	3.5	3.7
FYR Macedonia	230	1925	230	55	9	0	8	4.0	5.7
Slovakia	58	9	25	12	7	5	7	6.0	6.3
Czech Republic	52	13	18	10	8	9	9	9.0	8.7
Slovenia	247	93	23	18	9	9	9	9.0	9.0
Latvia	262	959	35	26	23	13	8	10.5	14.7
Moldova	151	2198	837	116	24	15	11	13.0	16.7
Poland	60	44	38	29	22	19	15	17.0	18.7
Estonia	304	954	36	42	29	15	12	13.5	18.7
Armenia	25	1341	10896	1885	32	6	19	12.5	19.0
Lithuania	345	1161	189	45	36	13	10	11.5	19.7
Hungary	32	22	21	21	28	20	17	18.5	21.7
Albania	104	237	31	16	6	17	42	29.5	21.7
Georgia	131	1177	7488	6473	57	14	9	11.5	26.7
Kyrgyzstan	170	1259	1363	96	32	35	24	29.5	30.3
Azerbaijan	126	1395	1294	1788	85	7	7	7.0	33.0
Kazakhstan	137	2984	2169	1160	60	29	12	20.5	33.7
Russia	144	2501	837	217	132	22	14	18.0	56.0
Romania	223	199	296	62	28	57	116	86.5	67.0
Uzbekistan	169	910	885	1281	117	64	40	52.0	73.7
Ukraine	161	2730	10155	401	182	40	15	27.5	79.0
Belarus	93	1558	1994	1900	243	40	99	69.5	127.3
Bulgaria	339	79	64	122	33	311	592	451.5	312.0
Turkmenistan	155	644	9750	1328	1262	446	44	245.0	584.0
Tajikistan	204	1364	7344	1	2132	41	105	73.0	759.3

REGIONAL AVERAGES	1991	1992	1993	1994	1995	1996	1997 (est)	Average 1996-1997	Average 1995-1997
CEE & NIS	145	1671	2284	467	142	38	37	37.7	72.5
Northern Tier CEE	85	138	39	25	20	16	13	14.5	16.5
Southern Tier CEE	240	347	322	63	24	97	189	142.7	103.0
NIS	147	2260	3150	641	191	36	22	28.7	82.8
European Union	5.1	4.5	3.8	3.0	2.9	2.5	1.9	2.2	2.4
Advanced Countries	4.7	3.5	3.1	2.6	2.5	2.4	2.2	2.3	2.4
Developing Countries	36.2	38.7	46.8	51.4	22.7	13.2	10.0	11.6	15.3
Benchmarks								<10.0	<15.0

Note: Retail/consumer prices, end-year.

Source: EBRD, *Transition Report 1997* (November 1997), and IMF, *World Economic Outlook* (October 1997).

Table 12. Fiscal Balance as Percent of GDP

Country	1991	1992	1993	1994	1995	1996	1997 (est.)	1994-1996 average
Czech Republic	-2.0	-3.3	2.7	0.8	0.4	-0.2	-1.0	0.3
Croatia	-5.0	-4.0	-0.8	1.7	-0.9	-0.5	-2.7	0.1
Slovenia	2.6	0.2	0.3	-0.2	0.0	0.3	-1.0	0.0
Estonia	5.2	-0.3	-0.7	1.3	-1.2	-1.5	...	-0.5
Slovakia	-2.0	-11.9	-7.0	-1.3	0.1	-1.2	-3.5	-0.8
Turkmenistan	2.5	13.2	-0.5	-1.4	-1.6	-0.2	...	-1.1
FYR Macedonia	...	-9.6	-13.6	-3.2	-1.3	-0.4	-1.0	-1.6
Belarus	3.6	-1.6	-1.9	-2.6	-1.9	-1.6	-2.7	-2.0
Romania	3.3	-4.6	-0.4	-1.9	-2.6	-3.9	-4.5	-2.8
Latvia	...	-0.8	0.6	-4.1	-3.5	-1.4	-0.9	-3.0
Poland	-6.7	-6.6	-3.4	-2.8	-3.6	-3.1	-4.0	-3.2
Lithuania	2.7	0.8	-3.1	-4.2	-3.3	-3.6	-2.8	-3.7
Kazakhstan	-7.9	-7.3	-1.3	-7.2	-2.0	-2.5	-4.2	-3.9
Ukraine	-13.6	-25.4	-16.2	-7.8	-4.9	-3.2	...	-5.3
Georgia	-3.0	-25.4	-26.2	-7.4	-4.5	-4.4	-3.5	-5.4
Uzbekistan	-3.6	-18.4	-10.4	-6.1	-4.1	-7.3	-3.0	-5.8
Hungary	-2.2	-5.5	-6.8	-8.2	-6.5	-3.5	-5.0	-6.1
Azerbaijan	-5.0	2.8	-12.7	-11.4	-4.2	-2.6	-2.0	-6.1
Moldova	...	-23.4	-6.8	-9.0	-5.5	-4.0	-4.5	-6.2
Russia	-31.0	-21.6	-7.2	-10.4	-5.5	-8.3	-8.0	-8.1
Bulgaria	...	-5.2	-10.9	-5.8	-6.4	-13.4	-6.3	-8.5
Tajikistan	-16.4	-31.2	-25.0	-10.5	-11.2	-5.3	...	-9.0
Kyrgyzstan	4.6	-17.4	-14.2	-7.7	-13.5	-6.4	-5.3	-9.2
Albania	-31.0	-22.0	-15.0	-12.0	-10.0	-12.0	...	-11.3
Armenia	-1.8	-8.1	-56.1	-16.5	-11.1	-9.3	-6.7	-12.3

REGIONAL AVERAGES	1991	1992	1993	1994	1995	1996	1997 (est.)	1994-1996 average
CEE & NIS	-15.5	-15.4	-8.1	-7.2	-4.6	-5.5	-5.6	-5.8
Northern Tier CEE	-4.1	-5.5	-3.0	-2.9	-3.0	-2.5	-3.4	-2.8
Southern Tier CEE	-1.7	-6.3	-4.4	-3.2	-3.7	-5.9	-4.5	-4.3
NIS	-19.9	-19.3	-10.0	-9.0	-5.1	-6.2	-6.5	-6.8
European Union			-6.5	-5.8	-5.2	-4.4		-5.1
Advanced Countries			-4.2	-3.4	-3.2	-2.7		-3.1
Developing Countries			-3.3	-2.6	-2.4	-2.2		-2.4
European Union Target								-3.0
Benchmark								-3.0

Note: General government balance for all countries except for Croatia, Turkmenistan, and the developing countries, for which central government balance is given.

Source: EBRD, *Transition Report 1997* (November 1997), and IMF, *World Economic Outlook* (October 1997).

Table 13. Domestic Investment and Private Sector Share of GDP

Country	Gross Domestic Investment 1990	1994 (% of GDP)	1995	1990-1995 % change	1994-1995 % change	Private Sector Output 1996 (% of GDP)	1997 (est.)
Albania	29	14	16	-45	14	75	75
Czech Republic	29	20	25	-14	25	75	75
Hungary	25	22	23	-8	5	70	75
Slovakia	34	17	28	-18	65	70	75
Estonia	30	33	27	-10	-18	70	70
Lithuania	34	...	19	-44	...	65	70
Russia	30	27	25	-17	-7	60	70
Poland	26	16	17	-35	6	60	65
Kyrgyzstan	24	...	16	-33	...	50	60
Latvia	40	11	21	-48	91	60	60
Romania	30	27	26	-13	-4	60	60
Armenia	47	10	9	-81	-10	50	55
Croatia	13	14	14	8	0	50	55
Georgia	...	...	3	...	...	50	55
Kazakhstan	43	24	22	-49	-8	40	55
Bulgaria	26	21	21	-19	0	45	50
FYR Macedonia	32	18	15	-53	-17	...	50
Slovenia	17	21	22	29	5	45	50
Ukraine	28	...	...	...	...	40	50
Moldova	...	8	7	...	-13	40	45
Uzbekistan	32	23	23	-28	0	40	45
Azerbaijan	28	23	16	-43	-30	25	40
Turkmenistan	40	...	...	...	...	20	25
Belarus	27	...	25	-7	...	15	20
Tajikistan	23	...	17	-26	...	20	20
REGIONAL AVERAGES	1990	1994 (% of GDP)	1995	1990-1995 % change	1994-1995 % change	1996 (% of GDP)	1997 (est)
CEE & NIS	29.6	23.4	22.2	-25.1	-5.1	52.5	60.0
Northern Tier CEE	27.5	17.8	20.3	-26.3	13.7	64.2	68.3
Southern Tier CEE	27.3	22.8	22.3	-18.3	-2.4	56.9	58.1
NIS	30.5	25.4	22.8	-25.4	-10.4	48.8	58.1
European Union			19				
OECD			20			70-85	
Developing Countries			27				
Sub-Saharan Africa			19				
East Asia/Pacific			39				
Benchmarks	*- GDI/GDP > 18% -*			*- no decline -*		*- more than 50% -*	

Source: EBRD, *Transition Report 1997* (November 1997), and World Bank, *World Development Indicators 1996/1997* (June 1996/1997)

Table 14. Labor Productivity

Region/Country	Labor Productivity in Industry/Manufacturing (% change) 1990	1991	1992	1993	1994	1995	1996	1997q1	1994-96 average	1996/1989 (%)
CEE										
Romania	-24.6	-18.5	-12.3	9.0	13.3	19.2	16.7	19.6	16.4	93
Poland	-21.1	-11.9	17.1	14.5	13.9	7.0	9.9	9.8	10.3	125
Hungary	0.4	-17.9	10.7	18.5	7.3	11.2	9.1	9.8	9.2	141
Czech Republic	-0.4	-16.6	-7.6	-3.5	4.9	11.1	9.6	1.1	8.5	95
Slovenia	-9.0	-1.0	-1.0	5.0	11.4	7.2	6.6	5.8	8.4	119
Bulgaria	-10.4	-11.1	0.2	5.5	12.6	7.3	3.3	...	7.7	105
Latvia	...	...	...	...	9.4	-1.1	12.6	-3.1	7.0	...
Croatia	-10.0	-14.0	-1.0	-2.0	1.6	5.8	11.4	10.8	6.3	90
Estonia	...	...	...	...	6.7	0.4	6.3	20.8	4.5	...
Slovakia	...	...	7.4	0.6	6.8	4.0	2.5	2.5	4.4	...
Lithuania	...	...	...	...	-12.1	11.9	4.9	-9.0	1.6	...
NIS										
Russia	1.0	-5.0	-12.0	-14.2	-17.7	4.8	1.3	6.4	-3.9	63
Ukraine	0.0	-5.0	-1.0	-1.0	-18.0	...	...		...	...

Note: 1997Q1 figures reflect the change since 1996Q1.

Source: EBRD, *Transition Report 1997* (November 1997), and previous editions of the EBRD report.

Table 15. Integration into the World Economy (I)

Country	Export Growth (average annual) 1994-1996	Openness to Trade (% of GDP) 1996	Current Account Balance (% of GDP) 1994-1996	1996	Institutional Integration 1997
Czech Republic	21	120	-2.6	-8.1	(1)(2)(3)(4)(5)
Hungary	24	66	-6.3	-3.8	(1)(2)(3)(4)(5)
Poland	22	52	-1.0	-1	(1)(2)(3)(4)(5)
Slovenia	12	98	1.3	0.3	(2)(3)(4)
Estonia	38	160	-7.1	-10.3	(3)(4)
Bulgaria	11	64	-0.6	1.3	(2)(3)
Romania	20	60	-2.6	-5.9	(2)(3)
Slovakia	17	126	0.4	-10.2	(2)(3)
Latvia	16	100	-3.1	-7.2	(3)
Lithuania	27	60	-3.5	-4.4	(3)
Albania	28	52	-11.0	-4.7	
Armenia	13	74	-30.5	-26.6	
Azerbaijan	4	80	-14.8	-23.6	
Belarus	29	78	-7.6	-6.7	
Croatia	5	98	-2.4	-7.6	
FYR Macedonia	-4	90	-9.1	-7.8	
Georgia	-2	30	-19.7	-4.9	
Kazakhstan	16	62	-5.0	-3.4	
Kyrgyzstan	17	88	-20.4	-23.7	
Moldova	23	106	-6.1	-13.1	
Russia	27	32	1.2	2.2	
Tajikistan	6	330	-8.5	-10.9	
Turkmenistan	-14	354	3.3	1.7	
Ukraine	7	88	-4.7	-2.7	
Uzbekistan	10	60	-2.7	-7.9	
CEE & NIS	19	65	-2.7	-2.8	
Northern Tier CEE	22	74	-2.1	-3.6	
Southern Tier CEE	16	66	-3.2	-4.6	
NIS	19	62	-2.7	-2.3	
European Union	6.9	57	0.6	1.0	
Advanced Economies	7.4	44	-0.3	-0.3	

Benchmarks (a) 3 year average export growth > 5%
(b) 3 year average current account balance no worse than -5%

Note: 1994-1996 indicators are average annual figures. Openness to trade is defined as exports plus imports expressed as a percentage of GDP. Institutional integration refers to membership or participation in (1) OECD, (2) WTO, (3) Europe Agreements with EU; (4) invited to participate in the next round of negotiations toward EU membership; (5) invited to join NATO.

Source: EBRD, *Transition Report Update 1997* (April 1997), IMF, *World Economic Outlook* (May 1997), and World Bank, *World Development Report 1997* (June 1997).

Table 16. Integration into the World Economy (II)

Country	Foreign Direct Investment (per capita) 1989-1996	Foreign Direct Investment (per capita) 1996	External Debt: Gross Debt (% of exports) 1996	External Debt: Gross Debt (% of exports) 1991-1996	External Debt: Debt Service (% of exports) 1996
Czech Republic	692	123	60	-11	12.8
Hungary	1300	195	201	-18	50.4
Poland	140	71	112	-196	7.6
Slovenia	372	90	30	30	9.0
Estonia	477	71	11	11	0.8
Bulgaria	51	12	160	-227	19.5
Romania	52	9	98	47	14.8
Slovakia	117	33	49	-32	10.8
Latvia	258	92	23	23	5.0
Lithuania	76	41	32	30	6.7
Albania	93	28	242	-360	6.4
Armenia	12	6	158	158	18.7
Azerbaijan	130	87	47	47	9.7
Belarus	16	7	52	51	2.5
Croatia	129	73	70	-275	8.4
FYR Macedonia	38	20	129	129	11.1
Georgia	7	5	253	253	9.8
Kazakhstan	187	67	56	24	5.5
Kyrgyzstan	33	7	164	163	18.0
Moldova	37	13	128	128	6.0
Russia	40	14	126	-29	7.3
Tajikistan	10	2	...	...	53.0
Turkmenistan	118	28	...	...	16.3
Ukraine	25	10	43	43	6.4
Uzbekistan	7	2	38	38	8.2
CEE & NIS	110	31	101	-20	10.1
Northern Tier CEE	389	92	101	-105	14.3
Southern Tier CEE	63	19	120	-75	14.2
NIS	44	17	98	12	8.4
Developing Countries			159		2.3
Benchmarks	(a) below the "moderately indebted" threshold (i.e., debt < 132% of exports)				
	(b) debt service less than 20%				

Note: Foreign Direct Investment figures for 1989-1996 are cumulative; 1991-1996 debt-to-export figures equal the difference between 1991 and 1996 ratios. Debt service is expressed as a percentage of exports of goods and services for Armenia, Azerbaijan, Belarus, Croatia, Czech Republic, Estonia, Georgia, Kazakhstan, Latvia, Moldova, Slovakia, Ukraine, and Uzbekistan; for Albania, Bulgaria, FYR Macedonia, Hungary, Poland, Romania, Russia, Slovenia, and Turkmenistan debt service is given as a percentage of current account revenue (excluding transfers). Debt service for Estonia is expressed as a percentage of exports of goods and non-factor services, and for Kyrgyzstan, Lithuania and Tajikistan debt service is given as a percentage of merchandise exports only.

Source: EBRD, *Transition Report 1997* (November 1997) and *Transition Report Update 1997* (April 1997), IMF, *World Economic Outlook* (May 1997), and World Bank, *World Development Report 1997* (June 1997).

2. Social Conditions

Ultimately, the sustainability of the transition hinges on the well-being of the individual. Humanitarian considerations are important. However, equally if not more compelling are the links between living standards, popular expectations, and the level of public support for economic and political reforms--reforms which have coincided with, if not contributed to, both a dramatic initial drop in overall income and significant increases in income inequalities and poverty in most cases.

Tables 17 through 23 highlight social conditions. **Unemployment** needs to be a concern. It is a relatively new phenomenon for the region, and, as *Table 17* highlights, it is significant, at least in CEE. The good news may be that the unemployment rate in CEE seems to be declining; 1993 looks to be the peak year. Also, it is interesting to note that the current CEE average of roughly eleven percent is on par with the unemployment rate in the EU.

The average CEE unemployment rate masks wide variation. The unemployment rate in Macedonia may be as high as one in four persons in the labor force. In contrast, the official unemployment rate in the Czech Republic is less than four percent. The official unemployment rates in the Baltics are also low, though this may reflect in part the relatively flawed system of data collection inherited from the Soviet Union.

Measuring unemployment through surveys—rather than using the more commonly-available official registered unemployment figures—tends to uncover a larger problem. For example, the official unemployment rate in Romania in 1996 was close to eight percent. A household survey conducted in the early part of 1996, however, revealed unemployment to be closer to fifteen percent; that is, roughly half of those unemployed did not register as such.[12]

The official unemployment figures in the NIS are generally much lower than in CEE. This may reflect a combination of phenomena. One may be poorer data collection techniques. More significant is likely to be the tendency for labor markets to adjust differently in the NIS at this point in the transition. In short, underemployment (in the form of fewer work hours, involuntary leave and wage arrears) in the NIS may to some extent exist in lieu of greater open unemployment. The degree of open unemployment currently experienced in CEE may be a reflection of what is to come in the NIS. Similarly, the lower, though growing, open unemployment in the NIS may be an indication of less progress in the restructuring process.[13]

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[12]For further elaboration and evidence on the discrepancy between official and survey unemployment rates, see *Labor Markets in CEE: Employment, Unemployment, and Labor Hoarding*, No.2, for USAID/ENI/PCS (February 1995).

[13]There may be some credible concern that the low unemployment rate in the Czech Republic is similarly a reflection in part of an incomplete economic restructuring process.

While the number of unemployed in CEE has not changed dramatically from year to year, a critical consideration is whether these figures represent the same people. In other words, how long are people typically unemployed? With safety nets disappearing, we know that unemployment is a crucial determinant towards poverty.

Monitoring **long-term unemployment** is hence important, and *Table 18* addresses this aspect in part. Many data gaps exist and we can only sketch a rough picture. Almost one in two persons unemployed in 1995 in the ten countries for which data are available were unemployed for more than one year. This represents a large increase from 1992 when one in five of the unemployed were long-term unemployed. It is interesting to note that this rising share of long-term unemployed is not solely a transition phenomenon; countries of Western Europe are also experiencing it.

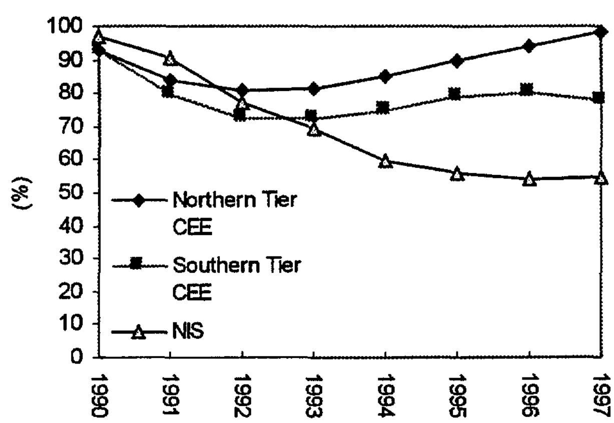
Long-term unemployment may be particularly troublesome for Macedonia and Albania, though more recent data are needed to confirm this. In 1993, eighty-seven percent of those unemployed in Macedonia were unemployed for more than one year. With very high total unemployment, this translates into very high long-term unemployment: seventeen percent. In 1993, sixteen percent of Albania's labor force (or sixty-five percent of all those unemployed) had been unemployed for more than one year.

Tables 19 and *20* shed light on living standards through indicators of income. The first observation is that the **average income** in the transition economies is significantly below that in the advanced economies. In purchasing power parity (PPP) terms, average income in ENI is roughly one-fifth the EU average. Furthermore, average income varies widely among ENI countries. Per capita income in Slovenia and the Czech Republic exceeds $10,000 in PPP terms; it is close to $1,000 in Tajikistan and Albania. In general, average income of the Northern Tier countries is much greater than per capita income of the rest; more than two times greater if measured in US dollars converting through official exchange rates.

What may be more important for our purposes is how the income levels have changed during the transition, and how it has been distributed within countries. Other things equal, the greater the income disparities and collapse in incomes, the more pronounced are the hardships and the greater is the likelihood of "reform fatigue."

In this regard, it is significant to note (as shown in *Table 19* and *Figure 5*) that only Poland has regained its pre-transition income level. Nevertheless, several other Northern Tier countries—Slovenia, the Czech

Figure 5: Real GDP as Percent of 1989 GDP



Source: EBRD, *Transition Report 1997* (November 1997)

Republic, and Slovakia—are not far behind, and the (weighted) Northern Tier average income today is ninety-eight percent of the income level in 1989. Nevertheless, two Northern Tier countries—Latvia and Lithuania—have incomes significantly below pre-transition levels.

The 1997 average income in the Southern Tier CEE (at less than eighty percent) lags considerably behind the Northern Tier. The NIS lag even more; 1997 (official) income in the NIS on average is fifty-five percent the income level of 1989.

We can fill in the picture further with **income distribution** data. In general, while income inequality has increased dramatically over the transition, the degree of inequality for most transition countries is below that found in most other regions of the world. These were highly egalitarian societies prior to the collapse of communism.

In CEE overall, the twenty percent of the population with the highest income receives roughly three times as much as the poorest twenty percent. This compares to a six-to-one ratio in the EU, and, where global inequality remains the highest, nineteen-to-one in Latin America.

The income distribution in Russia, in contrast, is perhaps as unequal as anywhere in the world. In fact by gini coefficient measures, income inequality in Russia is comparable to that found in Brazil.

Poverty has increased substantially in ENI as shown in *Table 20.* In fact, the overall poverty estimates tend to be quite low relative to some others. UNICEF, for example, cites a percentage point increase in poverty rates from 1989 to 1994 in: Lithuania by 64.7 percent; Latvia by 55.1 percent; Moldova by 54.9 percent; Azerbaijan by 50 percent; Bulgaria by 49.7 percent; Estonia by 46.0 percent; Russia by 45.5 percent; Romania by 31.7 percent; Slovakia by 27.2 percent; the Czech Republic by 22.5 percent; Hungary by 12.4 percent; and Poland by 12.2 percent.[14]

According to World Bank estimates, one in three persons in ENI are poor. However, this average masks very wide variation, by country and by groups within countries. Poverty remains negligible in Slovenia, the Czech Republic, and Slovakia. In contrast, roughly one out of two persons are considered poor by this standard in Turkmenistan, Kazakhstan, and Lithuania. The ratio is apparently even higher in Kyrgyzstan and Moldova.

One reason why the poverty estimates vary widely by country is because the poverty is apparently shallow in most of the region.[15] That is, many of the poor are only marginally so, and a relatively

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[14] UNICEF, *Poverty, Children and Policy: Responses for a Brighter Future*, Economies in Transition Studies, Regional Monitoring Report No. 3 (1995). If Lithuania's poverty rate in 1989 was 5%, its 1994 poverty rate by this count would be 70%.

[15] Romania is likely an exception. A recent World Bank study on poverty in Romania reveals few but deep pockets of poverty in Romania.

small change in the poverty line, can result in a relatively large change in the poverty rate.[16] There may be a significant turnover among those found in poverty as well.[17] Both trends have favorable implications for policy; both need to be explored further.

Table 20 also reveals, however, that a disproportionate burden from poverty is placed on different segments of society. The poverty estimates for children and the elderly cannot be directly compared with the country-wide estimates since the methods to calculate are different. A comparison between poverty among children with that of the elderly and how those rates have changed since 1989, however, is very revealing.

In general, the data suggest that poverty is much greater among children than it is among the elderly. This is the case in six of the eight countries for which data exist for 1992-1995. By this measure, poverty among Russian children increased from forty percent to over sixty percent since roughly 1990; from two percent to over forty percent in Bulgaria; nine percent to thirty-five percent in Romania; eight percent to twenty percent in Poland.

Poverty rates for the elderly on average in this limited sample are one-half that of children. Among the Northern Tier countries, poverty among the elderly is low and may actually be decreasing: four percent in 1989-1992 to three percent in 1992-1995. It may be that the elderly in some of these countries remain politically strong enough to be able to favorably influence pension rates and eligibility.

Table 21 highlights trends in **infant mortality rates** and **life expectancy**. The news is mixed and widely varied. The infant mortality rate is significantly lower in the Northern Tier countries than it is in the Southern Tier and the NIS. The Northern Tier rate is comparable to the OECD average (though still double the EU average). Furthermore, Northern Tier infant mortality rates have fallen significantly (twenty percent) since 1989. Progress is much more modest in the Southern Tier where rates have fallen five percent and is negligible on balance in the NIS.

Four countries—Albania, Latvia, Croatia, and Georgia—have witnessed a notable increase in the infant mortality rate. Infant mortality rates remains particularly high in the Central Asian Republics (thirty-five deaths per 1,000 live births on average in 1995), and in Albania (at forty-three deaths).

Life expectancy in CEE is seventy-one years, six years below the EU average. In the NIS, life

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[16] A World Bank study cites an increase in poverty in Hungary from 2% in 1989 to over 8% in 1993, using the minimum pension as the poverty line. A poverty line set at roughly one and half times the minimum pension, however, translates into a poverty rate from less than 5% in 1989 to anywhere from 33-40% in 1993. World Bank, *Hungary: Poverty and Social Transfers* (March 14, 1996).

[17] This conclusion at any rate would seem to apply to Russia. See: World Bank, *Poverty in Russia: An Assessment*, Human Resources Division, June 1995.

expectancy, at sixty-seven, is lower still. Five countries have experienced a decrease in life expectancy from 1991 to 1995. Life expectancy in Poland, Lithuania, Ukraine, and Tajikistan has decreased by one year since 1991; in Russia, it has dropped by at least two years.

As with physical capital, human capital is important for its direct effect on economic sustainability. It too, however, can provide indications of trends in living standards. *Table 22* provides some evidence, though many data gaps exist. In particular, the **secondary school enrollment** percentages remain quite high in the region, and not far from that found in the EU. Of the three sub-regions, secondary school enrollment is highest in the Northern Tier CEE and lowest in the Southern Tier CEE. Lowest enrollment, far and away, is found in Macedonia and Ukraine; only slightly more than one in two secondary school age children were enrolled in school in Macedonia in 1993 and in Ukraine in 1995.

While there has been some concern that enrollments may be deteriorating in the region, the evidence provides a mixed picture. The Northern Tier countries on average have witnessed an increase in secondary school enrollment from 1990-1995. The increase has been particularly pronounced in the Czech Republic and Hungary. Despite the average, the Baltic countries have experienced some decline in enrollment.

The available data for the NIS and Southern Tier CEE indicate a deterioration on balance in secondary school enrollment in these sub-regions. Georgia, Ukraine, and Azerbaijan have experienced significant enrollment declines from 1990-1995.

Table 22 also highlights trends in the UNDP's **Human Development Index** (HDI). The HDI is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy (two-thirds weight), and combined primary, secondary and tertiary enrollment ratios (one-third weight); and standard of living, as measured by real GDP per capita (PPP$). The HDI ranges from 0 to 1; the higher is the value, presumably the greater is the human development.

The UNDP classifies 175 countries into three categories in the *Human Development Report 1997*: high; medium; and low human development. It is based on 1994 data. Human development is considered to be high in six ENI countries (Slovenia, Czech Republic, Slovakia, Hungary, Poland, and Belarus), and medium in the rest. Belarus' classification may be surprising, though it scores relatively high on most of the components of the HDI; on life expectancy, literacy, and enrollment ratio.

HDI trends over time may be revealing, though more recent data would be helpful. The large majority of the transition countries saw their global ranking deteriorate from 1993 to 1994, though some of this is attributed to an increase in sample size in the most recent calculations. Perhaps more revealing is the trends in the scores from year to year. All the CEE countries (for which data are available) showed an increase in the HDI score from 1993 to 1994 except Latvia. In contrast, all the NIS saw a decrease in the HDI score from 1993 to 1994 except Belarus and Turkmenistan.

Finally, *Table 23* sheds some light on environmental developments. Environmental degradation was pervasive under central planning. A focus on maximizing production with little or no regard for environmental consequences and with a strong emphasis on heavy industry and highly energy-intensive methods contributed to much of this. Obviously, qualify of life and support for the transition are part of the issue here. However, increasing productivity and efficiency are also important.

Integral to this for the CEE countries in particular is membership into the EU which will require gradual adoption of the EU's environmental regulations. Substantial investments will likely need to accompany the establishment of a viable regulatory regime and appropriate energy prices. A 1993 study of six CEE countries (Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovakia) estimated environmental investments of fifteen to twenty percent of GDP to bring them up to EU standards.[18]

While we have far to go towards better monitoring the environment in the transition economies, *Table 23* fills in a small part of the picture by addressing in part **environmental efficiency and quality**. More efficient use of natural resources (that is, greater environmental efficiency) should translate into lower pollution, at least on a unit of production basis. Energy and water use intensity seem to be reasonable measures of this efficiency.

For this measure, **electricity intensity** of output in 1994 is examined. The electric power sector is a major source of air pollution in ENI, particularly in those countries that rely primarily on coal, lignite, and oil shale as their primary energy source.

Table 23 reveals substantial differences in electricity intensity of output in 1994 between the ENI countries and the industrial market economies, as well as within ENI. Electricity intensity in CEE is twice as high as that found in the EU; in the NIS, it is more than three times higher. Electricity intensity is highest in ENI in the Central Asian Republics and Azerbaijan where energy resources are plentiful. Electricity intensity is highest among CEE countries in Bulgaria and Lithuania which rely heavily on nuclear power generation (and where nuclear safety needs to be a big concern).

Table 23 also shows 1992 **carbon dioxide emissions** (per unit of GDP and per capita), and annual mean concentrations of three **common air pollutants**—sulphur dioxide, nitrogen dioxide, and total suspended particulates—in parts per million for major cities in eighteen ENI and eight Western Europe countries for the period 1990-1992. Such emissions are used as proxies for environmental quality. Bearing in mind the many data gaps, and widely varying results per city, the

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[18]Environmental Resource Management, ***Environmental Standards and Legislation in Western and Eastern Europe: Towards Harmonization***, Final Report prepared for EBRD/EU-Phare, December 1993.

regional averages in sulphur dioxide and nitrogen dioxide emissions in the early transition years are roughly comparable between ENI and the EU. In contrast, TSP concentrations were twice as high in ENI vis-a-vis Western Europe, and carbon dioxide emissions per GDP many multiples higher in ENI.

A 1994 Bureau of Census study reported a decrease in air pollution emissions in several CEE countries (with the apparent exception of the Czech Republic) in the early transition years.[19] Such a trend, however, is likely attributed in large part to an overall drop in production. More recent figures might reveal increasing pollution coinciding with economic growth.

[19]Bureau of Census, *Populations at Risk in CEE: An Overview*, No. 1, prepared for USAID/ENI/PCS (November 1994).

Table 17. Unemployment Rate

	1991	1992	1993	1994	1995	1996	1997	1994-1996 (average)
CEE:								
Czech Republic	4.1	2.6	3.5	3.2	2.9	3.5	...	3.2
Estonia	...	...	5.0	5.1	5.1	5.6	...	5.3
Lithuania	0.3	1.3	4.4	3.8	6.2	7.0	...	5.7
Latvia	...	2.3	5.8	6.5	6.6	7.2	...	6.8
Romania	...	6.2	9.2	11.0	9.9	7.8	...	9.6
Hungary	7.5	12.3	12.1	10.4	10.4	10.5	10.0	10.4
Bulgaria	11.5	15.6	16.4	12.8	10.5	12.5	...	11.9
Slovakia	...	...	12.2	13.7	13.1	11.1	...	12.6
Slovenia	8.2	11.5	14.4	14.4	13.9	13.9	13.8	14.1
Poland	11.8	13.6	16.4	16.0	14.9	13.6	...	14.8
Croatia	13.2	13.2	14.8	14.5	14.5	16.4	...	15.1
Albania	8.3	24.4	24.8	16.9	13.9	...	...	15.4
Macedonia	19.2	19.8	20.0	23.7	24.9	...	...	24.3
NIS:								
Uzbekistan	0.0	0.1	0.3	0.4	0.3	0.6	...	0.4
Ukraine	0.0	0.3	0.4	0.4	0.5	1.3	...	0.7
Moldova	...	0.1	0.7	1.1	1.4	1.6	...	1.4
Kazakhstan	0.0	0.5	0.6	0.8	1.7	3.6	...	2.0
Tajikistan	...	0.3	1.1	1.7	1.8	2.8	...	2.1
Kyrgyzstan	0.0	0.1	0.2	0.7	3.0	4.5	...	2.7
Belarus	0.0	0.5	1.4	2.1	2.7	3.9	...	2.9
Armenia	...	...	5.2	6.4	6.6	9.1	...	7.4
Russia	0.0	4.8	5.6	7.4	8.2	9.3	...	8.3
Azerbaijan	...	15.0	16.0	15.0	17.0	20.0	...	17.3
Georgia	...	5.4	8.4	...	...	...	...	...
Turkmenistan	2.0	...	...	...	3.0	...	...	...
CEE & NIS	...	5.3	6.4	7.0	7.2	7.8	...	7.4
Northern Tier CEE	9.8	11.2	12.5	12.1	11.5	10.9	...	11.5
Southern Tier CEE	12.3	11.1	13.1	12.9	11.6	11.1	...	11.9
NIS	...	3.2	3.8	4.8	5.4	6.5	...	5.6
Advanced Economies		7.3	7.7	7.6	7.3	7.3	7.2	7.4
U.S.		7.5	6.9	6.1	5.6	5.4	7.0	5.7
EU		9.9	11.1	11.6	11.2	11.3	11.3	11.4
Benchmarks						11.0	...	14.0

Note: 1994-95 average for Albania and Macedonia.
Source: EBRD, *Transition Report 1997* (November 1997); IMF, *World Economic Outlook* (May 1997); C. Allison and D. Ringold, *Labor Markets in Transition in Central and Eastern Europe: 1989-1995*, World Bank, Social Challenges of Transition Series (December 1996); Bureau of Census, *Populations at Risk in CEE: Labor Markets*, No 2, for USAID/ENI/PCS (February 1995); and Economist Intelligence Unit, *Country Reports* (various countries).

Table 18. Long-Term Unemployment In CEE

Country	(% of Labor Force) 1992	1993	1994	1995	(% of Total Unemployed) 1992	1993	1994	1995	(% change) 1992/3 to 1994/5
Albania	...	14.5	...	...	...	65	...	...	...
Bulgaria	...	8.7	7.6	6.9	...	53	59	66	25
Croatia	8.9	8.6	8.0	...	58	58	55	...	-5
Czech Republic	0.4	0.7	0.7	0.9	14	19	22	31	121
Estonia	...	...	...	...	...	...	...	...	...
Hungary	2.2	4.0	4.3	5.0	18	33	41	48	167
Latvia	...	...	...	...	...	...	...	...	...
Lithuania	...	...	...	...	...	...	...	...	...
FYR Macedonia	22.5	24.1	...	...	86	87	...	...	...
Poland	3.3	5.7	6.1	6.3	24	36	38	42	75
Romania	1.7	...	5.0	4.2	21	...	45	47	124
Slovakia	...	4.8	6.4	7.1	...	33	43	54	64
Slovenia	5.3	7.9	8.2	7.4	46	55	57	53	15
Northern Tier CEE	2.7	4.7	5.1	5.4	22	33	37	43	93
Southern Tier CEE	4.3	11.4	6.0	4.9	31	60	50	52	66
CEE Overall	3.2	6.1	5.4	5.2	25	39	41	46	82
France	3.7	3.9	4.7	5.3	36	34	38	46	28
Germany	2.5	3.6	4.2	4.5	33	40	44	48	45
Spain	8.6	11.4	13.6	13.1	47	50	56	57	21
Sweden	0.4	0.9	1.4	1.2	8	11	17	16	100
Benchmark	Long-term unemployment less than 8% of the labor force								

Note: The long-term unemployed are those who are unemployed for more than one year.
Source: C. Allison and D. Ringold, *Labor Markets in Transition in Central and Eastern Europe: 1989-1995*, World Bank, Social Challenges of Transition Series (December 1996), and Bureau of the Census, *Populations at Risk in CEE: Labor Markets*, No. 2, prepared for USAID/ENI/PCS (February 1995).

Table 19. Income and Its Distribution

	1997 Average Income		Distribution of Income		1997/1989
	US$	PPP$	89/90	92/93	GDP (%)
Poland	3,650	6,040	2.4	3.0	110
Slovenia	9,650	11,360	2.7	3.1	99
Czech Republic	5,390	10,270	2.4	3.2	97
Slovakia	3,680	8,330	2.4	2.5	94
Hungary	4,490	6,670	3.4	3.7	89
Romania	1,420	4,520	2.0	2.8	87
Uzbekistan	400	2,430	...	...	86
Estonia	3,210	4,740	...	7.0	76
Croatia	4,190	4,290	3.1	3.4	74
Albania	680	1,190	...	...	73
Belarus	1,350	4,460	...	3.0	66
Bulgaria	970	3,900	2.6	3.3	63
Kyrgyzstan	400	1,820	...	...	60
Kazakhstan	1,300	3,780	...	5.4	58
Russia	3,020	4,300	...	14.5	57
FYR Macedonia	1,880	2,190	...	3.5	56
Latvia	2,080	3,600	...	3.8	54
Turkmenistan	390	1,930	...	6.4	51
Lithuania	2,820	4,980	...	5.2	44
Azerbaijan	470	1,780	...	...	41
Armenia	470	2,530	...	...	39
Ukraine	840	2,090	...	3.7	37
Tajikistan	170	830	...	...	36
Georgia	930	1,800	...	...	34
Moldova	430	1,860	...	6.0	34
CEE & NIS	**2,300**	**4,110**	**...**	**8.3**	**65**
Northern Tier CEE	**4,070**	**6,850**	**2.6**	**3.3**	**98**
Southern Tier CEE	**1,610**	**3,990**	**2.3**	**3.0**	**78**
NIS	**1,940**	**3,410**	**...**	**10.7**	**55**
Advanced Economies	**25,100**	**21,600**			
EU	**21,830**	**19,540**	**6.0**		
Benchmark	(a) current year GDP equal to 85% of 1989 GDP				

Note: Average (or per capita) income is measured in US$ converting through official exchange rates; and through purchasing power parity (PPP) figures. PPP figures, with one exception, are derived from 1995 or 1996 levels and updated to 1997 from real economic growth estimates; that for Croatia is updated in this fashion from a 1993 income level. Income distribution: income of the 20% of the population with the highest income to income of the lowest-income 20% of the population. Average Income figures for the Advanced Economies and EU are for 1996.

Source: EBRD, *Transition Report Update 1997* (November 1997), World Bank, *World Development Report 1997* (June 1997), and J. Rutkowski, *Changes in the Wage Structure during Economic Transition in CEE*, Social Challenges of Transition Series (October 1996).

Table 20. Poverty

Country	Children		Elderly		Overall	
	1989-1992	1992-1995	1989-1992	1992-1995	1987-1988	1993-1995
Slovenia	8	...	7	...	0	1
Czech Republic	0	1	0	1	0	1
Slovakia	0	9	0	1	0	1
Hungary	2	7	1	1	1	6
Belarus	...	...	...	...	1	11
Poland	8	20	5	3	6	12
Latvia	51	...	15	...	1	19
Estonia	27	34	38	38	...	23
Uzbekistan	...	...	...	...	24	29
Romania	9	35	12	19	6	32
Bulgaria	2	43	4	28	2	33
Russia	40	62	23	34	2	38
Ukraine	...	...	...	...	2	41
Turkmenistan	...	...	...	...	12	48
Lithuania	...	...	...	...	1	49
Kazakhstan	...	...	...	...	5	50
Moldova	3	...	3	...	4	65
Kyrgyzstan	...	...	...	...	12	76
Azerbaijan	73	...	65	...	...	...
Albania	...	...	...	...	...	...
Croatia	...	...	...	...	...	...
FYR Macedonia	...	...	...	...	...	...
Armenia	...	...	...	...	...	...
Tajikistan	...	...	...	...	...	...
Georgia	...	...	...	...	...	...
CEE & NIS	28	46	17	24	4	33
Northern Tier CEE	7	14	4	3	3	11
Southern Tier CEE	7	37	10	21	5	32
NIS	41	62	24	34	4	39
UK					1	
Turkey					31	
Malaysia					15	
Brazil					33	

Note: The two poverty measures are not directly compatible: (1) overall poverty rates describe the percent of population below poverty line of $120 per capita per month at 1990 international prices; (2) for children and elderly, the poverty threshold is roughly 25 percent of the average 1989 wage.

Source: B. Milanovic, *Income, Inequality, and Poverty during the Transition*, Research Paper Series No. 11, World Bank (1996); UNICEF, *Poverty, Children, and Policy: Reponses for a Brighter Future*, Economies in Transition: Regional Monitoring Report 3 (1995); UNDP, *Human Development Report 1997* (May 1997); and Bureau of the Census, *Populations at Risk*, No. 5, for ENI/PCS/PAS (July 1996).

Table 21. Infant Mortality and Life Expectancy

	Infant Mortality				Life Expectancy		
				% Change			% Change
	1989	1991-1993	1995	1989-1995	1991-1993	1995	1991/3-1995
Slovenia	8	8	7	-25	73	74	1.4
Croatia	...	12	16	33	73	74	1.4
Czech Republic	10	10	8	-20	72	73	1.4
FYR Macedonia	...	28	23	-18	72	73	1.4
Slovakia	14	12	11	-21	71	72	1.4
Hungary	16	14	11	-31	69	70	1.4
Uzbekistan	...	35	30	-14	69	70	1.4
Moldova	20	20	21	5	68	69	1.5
Turkmenistan	...	46	46	0	66	67	1.5
Georgia	20	15	25	20	73	73	0
Albania	31	32	43	39	73	73	0
Armenia	20	18	14	-30	71	71	0
Bulgaria	14	16	15	7	71	71	0
Estonia	15	15	15	0	70	70	0
Romania	27	23	21	-22	70	70	0
Azerbaijan	26	26	23	-12	70	70	0
Belarus	12	12	13	8	70	70	0
Latvia	11	16	18	64	69	69	0
Kazakhstan	...	27	27	0	69	69	0
Kyrgyzstan	...	31	30	-3	68	68	0
Poland	19	17	14	-26	71	70	-1.4
Lithuania	11	15	12	9	70	69	-1.4
Ukraine	13	14	14	8	70	69	-1.4
Tajikistan	...	45	42	-7	68	67	-1.5
Russia	18	18	18	0	67	65	-3
CEE & NIS	...	19.2	18.6	-4.1	69.0	68.1	-1.2
Northern Tier CEE	15.9	14.8	12.4	-20.4	70.8	70.6	-0.3
Southern Tier CEE	24.2	20.1	21.0	-4.8	70.9	71.1	0.2
NIS	...	20.2	19.9	0.2	68.2	67.1	-1.7
LDCs			60			65	
Middle-Income			39			68	
OECD			12			76	
EU			6			77	
Benchmarks			30	no worsening		68	no worsening

Note: Infant mortality rate is per 1,000 live births; and life expectancy is in years. The OECD infant mortality rate average is significantly pulled up by 2 members: Turkey at 48 & Mexico at 33. Percent change in infant mortality is calculated from 1991-93 to 1995 when 1989 data are not available; latest values available for Georgia and Albania are for 1994.

Source: EBRD, *Transition Report 1997* (November 1997), UNICEF, *Children at Risk*, Regional Monitoring Report, No. 4 (1997), and World Bank, *World Development Report* (June 1997 & 1996).

Table 22. Human Development

	Secondary School Enrollment (% of age group)				Human Development Index			
					1993		1994	
Country	**1990**	**1993**	**1995**	**% change**	**Score**	**Rank**	**Score**	**Rank**
Slovenia	80.3	82.9	82.5	3	--	--	0.886	35
Czech Republic	79.6	88.5	97.4	22	0.872	37	0.882	39
Slovakia	88.2	93.2	91.7	4	0.864	41	0.873	42
Hungary	74.5	78.2	91.1	15	0.855	46	0.857	48
Poland	77.8	80.6	83.1	7	0.819	56	0.834	58
Belarus	86.0	84.0	84.4	-2	0.787	61	0.806	62
Russia	95.3	91.4	92.0	-3	0.804	57	0.792	67
Bulgaria	77.0	70.6	76.1	-1	0.773	62	0.780	69
Estonia	88.8	83.7	78.6	-11	0.749	68	0.776	71
Lithuania	93.4	82.7	85.4	-9	0.719	81	0.762	76
Croatia	77.0	83.0	--	8	--	--	0.760	77
Romania	81.9	75.2	76.9	-6	0.738	74	0.748	79
FYR Macedonia	53.0	54.0	--	2	--	--	0.748	80
Turkmenistan	--	--	--	--	0.695	90	0.723	85
Latvia	83.5	79.0	81.0	-3	0.820	55	0.711	92
Kazakhstan	--	90.0	--	--	0.740	72	0.709	93
Ukraine	61.2	44.8	54.8	-10	0.719	80	0.689	95
Uzbekistan	--	94.0	--	--	0.679	94	0.662	100
Albania	78.0	--	--	--	0.633	104	0.655	102
Armenia	--	85.0	--	--	0.680	93	0.651	103
Azerbaijan	76.0	75.0	68.0	-11	0.665	96	0.636	105
Georgia	94.9	75.9	76.0	-20	0.645	101	0.637	105
Kyrgyzstan	--	--	--	--	0.663	99	0.635	107
Moldova	90.0	85.0	92.0	2	0.663	98	0.612	110
Tajikistan	--	--	--	--	0.616	105	0.580	115
CEE & NIS	84.0	80.9	82.1	-2.2	0.75		0.76	
Northern Tier CEE	79.6	82.4	86.7	9	0.81		0.84	
Southern Tier CEE	78.5	74.0	--	--	0.74		0.75	
NIS	86.4	81.4	82.1	-5	0.76		0.74	
EU		90.0			0.92		0.93	
Thailand							0.83	
Turkey							0.77	
Jamaica							0.74	
Benchmark		no decline in enrollment						

Note: The HDI ranges from 0 to 1; the higher the value, the greater the human development. Percent change in secondary school enrollment is from 1990 to 1995, data permitting.

Source: EBRD, *Transition Report 1997* (November 1997), UNICEF, *Children at Risk*, Regional Monitoring Report, No. 4 (1997), World Bank, *World Development Report 1996* (June 1996) & UNDP, *Human Development Reports* (May 1997 & March 1996).

Table 23. Environment

Country	Environmental Quality: CO₂ Emissions per unit of GDP (1992)	CO₂ Emissions per capita (1992)	Air Pollution Concentrations (1990-1992) parts per million: City	SO_2	NO_2	TSP	Efficiency: Electricity Intensity (1994)
Albania	18.0	1.2	Tirana	23	...	85	400
Latvia	2.6	5.6	Riga	4	60	100	450
Croatia	...	3.4	Zagreb	39	...	67	540
Hungary	2.6	5.8	Budapest	44	44	62	550
Slovenia	...	2.8	Ljubljana	50	54	23	600
Poland	6.0	8.9	Warsaw	30	54	...	650
(Poland)			Krakow	47	31	54	...
Armenia	1.8	1.1	...	...	...	...	700
Belarus	4.0	9.9	Minsk	20	37	100	700
Slovakia	2.5	7.0	Bratislava	20	...	58	700
Czech Republic	4.4	13.1	Prague	75	56	84	710
Estonia	4.9	13.5	...	...	...	...	750
Romania	4.5	5.4	Bucharest	40	36	130	840
Moldova	...	3.3	Chisinau	2	20	...	850
Uzbekistan	8.5	5.7	...	...	...	...	860
Lithuania	3.1	5.9	Vilnius	...	27	...	950
Bulgaria	2.4	6.4	Sofia	31	53	170	1000
Russia	5.5	14.1	Moscow	...	76	100	1100
(Russia)			St. Petersburg	5	58	90	...
Ukraine	6.9	11.7	Kyiv	13	50	100	1180
(Ukraine)			Odessa	44	97	270	...
FYR Macedonia	...	2.0	...	...	...	...	1200
Georgia	3.0	2.5	...	...	...	...	1300
Kyrgyzstan	4.3	3.4	...	...	...	...	1300
Azerbaijan	13.6	8.7	...	...	...	...	1400
Kazakhstan	12.6	17.6	...	...	...	...	1400
Turkmenistan	...	10.5	...	...	..	...	1900
Tajikistan	1.6	0.7	...	...	..	...	2005
CEE & NIS	5.6	10.5		21	59	106	1010
Northern Tier CEE	4.7	8.6		43	45	61	660
Southern Tier CEE	4.7	4.9		37	41	127	820
NIS	6.2	11.8		11	65	117	1130
European Union	0.6			23	55	50	350

Note: CO_2 emissions are per capita and per unit of GDP for 1992. Air pollution concentrations are annual mean concentrations of sulphur dioxide (SO_2), nitrogen dioxide (NO_2), and total suspended particulates (TSP) in parts per million for major cities during the period 1990 to 1992. EU average is derived from data for 8 countries. Electricity intensity refers to the 1994 electricity consumption per $US 1,000 of GDP at PPP exchange rates (1993 for Tajikistan, Turkmenistan, Georgia, Uzbekistan, and Albania).

Source: EBRD, *Transition Report 1996* (November 1996), and UNDP, *Human Development Report 1997* (May 1997).

IV. Concluding Remarks

Decisions on the magnitude and duration of U.S. assistance to the ENI region are made on the basis of several factors:

(a) progress the country has made toward a sustainable transition to a market-based democracy;

(b) strategic importance of the country to the United States;

(c) importance of the recipient country to U.S. citizens; and

(d) effectiveness of particular assistance activities.

This paper has presented an approach to analyzing the first factor. The second and third are not as readily quantifiable but are matters of judgment that are regularly considered, along with the first, in making country-level budget decisions. The fourth factor, based on both regular reporting against strategic objective targets and on occasional field-based evaluations, is used primarily to inform the allocation of country budget levels among strategic objectives but is also a basis for determining whether a country assistance program is having enough impact to warrant continuation.

USAID will collect, analyze, and report on the country performance indicators two times a year: (a) each winter prior to the spring USAID review of mission strategies and USAID performance monitoring (and subsequent to EBRD's annual update of its economic policy indicators); and (b) each summer after Freedom House presents its annual democracy ratings. These data will also be provided to the State Department-based Coordinators for U.S. Assistance to CEE and the NIS and discussed with them when country planning levels are determined.

The overall rankings of the ENI countries in terms of economic policy reforms and democratic freedoms (as depicted in *Table 9*) provide a rough guide to policy in this regard. Countries ranked near the top of the list are obvious candidates for earlier "graduation". Countries near the bottom of the list would seem to fall into one of three contrasting categories: (1) those where assistance is least likely to be effective, in which case it may make sense to close those programs down altogether or to keep highly targeted funding at minimal levels until their commitment to reform increases; (2) these where reform now appears likely but requires greater resources; or (3) those which possess characteristics that match well with the Agency's priorities for sustainable development programs. Countries in the middle of the list are likely candidates for continuing programs through existing funding mechanisms, as long as the assistance is effective and Congress continues to appropriate funds for this purpose.

In addition, by looking beyond the aggregate rankings and developing a decision tree methodology, this paper attempts to more rigorously devise criteria towards graduation from U.S. assistance. First, do the countries achieve some acceptable level of progress in both economic policy reforms and democratization? Acceptable thresholds must occur in both before we consider sustainability.

Next, are the economic policy reforms translating into robust and sustainable macroeconomic outcomes? In addition, are trends in the social conditions such that the economic and political reforms are not likely to be thwarted or side-tracked?

Finally, an application of the decision tree methodology in concert with the proposed graduation benchmarks leads to the conclusion that there is likely a handful of current leading contenders for graduation from USAID assistance in CEE. Further elaboration and interpretation of how each country of the region scores overall in this regard is an important objective of the review process, both in-house and outside USAID.

APPENDIX I: ECONOMIC & DEMOCRATIC REFORM INDICATORS

A. Economic Policy Reforms: Indicators & Description of EBRD's Rating Categories

First Round Reforms

Small-scale Privatization
1 Little progress
2 Substantial share privatized
3 Nearly comprehensive program implemented, but design or lack of government supervision leaves important issues unresolved (e.g. lack of tradability of ownership rights)
4 Complete privatization of small companies with tradable ownership rights
5 Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land

Price Liberalization
1 Most prices formally controlled by the government
2 Price controls for several important product categories, including key infrastructure products such as utilities and energy; state procurement at non-market prices remains substantial
3 Substantial progress on price liberalization including for energy prices; state procurement at non-market prices largely phased out
4 Comprehensive price liberalization; utility pricing ensuring cost recovery
5 Standards and performance typical of advanced industrial economies: comprehensive price liberalization; efficiency-enhancing regulation of utility pricing

Trade & Foreign Exchange System
1 Widespread import and/or export controls or very limited legitimate access to foreign exchange
2 Some liberalization of import and/or export controls; almost full current account convertibility in principle but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates)
3 Removal of most quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services.
4 Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services
5 Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in GATT/WTO

Second Round Reforms

Large-scale Privatization

1 Little progress

2 Comprehensive scheme almost ready for implementation; some sales completed

3 More than 25 percent of large-scale state-owned enterprise assets privatized or in the process of being sold, but possibly with major unresolved issues regarding corporate governance

4 More than 50 percent of state-owned enterprise assets privatized in a scheme that has generated substantial outsider ownership

5 Standards and performance typical of advanced industrial economies: more than 75 percent of enterprise assets in private ownership with effective corporate governance

Enterprise Restructuring

1 Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance

2 Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to break up dominant firms

3 Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (e.g. through privatization combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation)

4 Strong financial discipline at the enterprise level; substantial improvement in corporate governance through government restructuring program or an active corporate control market; significant action to break up dominant firms

5 Standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring

Third Round Reforms

Competition Policy

1 No competition legislation and institutions; widespread entry restrictions

2 Competition policy legislation and institutions set up; some reduction of entry restrictions or enforcement action on dominant firms

3 Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions

4 Significant enforcement actions to reduce abuse of market power and to promote a competitive environment

5 Standards and performance typical of advanced industrial economies: effective enforcement of competition policy; unrestricted entry to most markets

Banking Reform

1 Little progress beyond establishment of a two-tier system

2 Significant liberalization of interest rates and credit allocation; limited use of directed credit or interest rate ceilings

3 Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalization with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks

4 Significant movement of banking laws and regulations towards BIS standards; well-functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening

5 Standards and performance norms of advanced industrial economies: full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services

Non-Bank Financial Institutional Reform

1 Little progress

2 Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities

3 Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergence of non-bank financial institutions (e.g. investment funds, private insurance and pension funds, leasing companies) and associated regulatory framework

4 Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalization; well-functioning non-bank financial institutions and effective regulation

5 Standards and performance norms of advanced industrial economies: full convergence of securities laws and regulations with IOSCO standards; fully developed non-bank intermediation

Legal Reform for Investment

1 Legal rules often very unclear and impose significant constraints to creating investment vehicles, security interests or repatriation of profits; availability of legal advice is limited; judicial and administrative support of the law is substantially deficient

2 Legal rules often unclear; legal advice often difficult to obtain; legal rules impose constraints to creating investment vehicles, the taking of security or repatriation of profits; judicial and administrative support of the law is rudimentary; where adequate legal rules or legal advice exist, administration of the law is deficient

3 Legal rules do not impose major obstacles to the creation of investment vehicles, the taking of security or the export of profits; legal rules are reasonably clear and specialized legal advice is available; judicial and administrative support of the law is often inadequate; where such support is adequate, legal rules often impose significant constraints

4 Legal rules are clear, generally do not discriminate between foreign and domestic investors and impose few constraints; specialized legal advice readily available; investment laws reasonably well administered and supported judicially, although that support is sometimes patchy

5 Legal rules closely approximate generally accepted standards internationally and are readily

ascertainable through sophisticated legal advice; investment laws are well administered and supported judicially, particularly regarding functioning of courts and land and the orderly and timely registration of proprietary or security interests.

Environmental Policy Reform

The environmental policy reform indicator is drawn from EBRD (November 1997). Four components go into it (see table below). The first is the degree of adherence to six key international environmental treaties: the Convention on the Wetlands of International Importance; the Convention on International Trade in Endangered Species of Wild Fauna and Flora; the Montreal Protocol for the control of CFC emissions; the Convention on Climate Change; the Convention on Biodiversity; and the Convention on Environmental Impact in a Transboundary Context. Countries are put into three groups on the basis of their progress towards signing and ratifying these treaties.

The second component attempts to measure progress in air and water ambient and emission (effluent) standards. Three levels of progress are identified: (1) the maximum permissible concentrations (MPC) system in place, broadly based on the former Soviet system; (2) a new system is being introduced, either as an evolution of MPC or in order to meet EU requirements; and (3) essentially new standards system is in place, often following EU requirements.

The third component attempts to measure progress in preparing and implementing national environmental action plans (NEAPs). Countries either have a NEAP planned or under preparation; or they have a NEAP prepared and under implementation.

Finally, the fourth component tries to assess the extent to which environmental financial mechanisms are used. From an EBRD questionnaire sent to the authorities in charge of the environment in each of the countries, information on four instruments were compiled: (1) existence of an environmental fund for channeling the money collected in fees and fines to environmental investments; (2) provision of taxes/other penalties or financial incentives for energy and resource efficiency; (3) waste and pollution reduction; (4) the use of clean technologies. Countries were grouped in two: those in which three or more financial instruments are in place; and those with less than three instruments in place.

USAID/ENI's Office of Environment, Energy, and Urban Development has been developing an environmental reform index. Once complete, the results and method should be compared with those of this indicator, drawn from EBRD.

Appendix I. Table 1. Environmental Policy Reform

	Treaties	Standards	NEAPs	Financial Instruments	Average
Czech Republic	5	5	4	4	4.5
Hungary	5	5	4	4	4.5
Poland	5	5	4	4	4.5
Slovakia	5	3	4	4	4.0
Estonia	3	3	4	4	3.5
Latvia	5	3	4	2	3.5
Romania	5	3	4	2	3.5
Russia	5	1	4	4	3.5
Croatia	3	3	2	4	3.0
Lithuania	3	1	4	4	3.0
Moldova	3	1	4	4	3.0
Ukraine	3	1	4	4	3.0
Slovenia	3	3	2	2	2.5
Bulgaria	5	1	2	2	2.5
Belarus	3	1	4	2	2.5
Albania	3	1	4	2	2.5
Georgia	5	1	2	2	2.5
Armenia	3	1	2	2	2.0
Azerbaijan	1	1	2	4	2.0
FYR Macedonia	1	1	4	2	2.0
Kyrgyzstan	1	1	4	2	2.0
Turkmenistan	1	1	4	2	2.0
Kazakhstan	1	1	2	2	1.5
Tajikistan	1	1	2	2	1.5
Uzbekistan	1	1	2	2	1.5
CEE & NIS					**3.2**
Northern Tier CEE					**4.3**
Southern Tier CEE					**3.1**
NIS					**2.9**

Note: On a 1-5 scale with 5 the most advanced. See text for an elaboration of the components.

Source: EBRD, *Transition Report 1997* (November 1997), pp. 32-33.

B. Freedom House's Rating Scheme on Economic Policy

In its Nations in Transit 1997, Freedom House measures progress towards economic reforms by assessing a series of questions in two broad categories: "privatization" and the "economy." Progress towards each category is rated on a seven-category scale, 1 representing the most advanced and 7 the least advanced, and the two are averaged. To conform with the EBRD scheme, we convert the 1-to-7 scale to 1-to-5, with 5 representing the most advanced.

Privatization
(1) What percentage of the GDP comes from private ownership?
(2) What major privatization legislation has been passed?
(3) What proportion of agriculture, housing and land, industry, and business and services is in private hands?
(4) Has there been reform of the state sector? (What major legislation has been passed? Do authorities and state managers act within the law? Is the state sector performing more efficiently? Does it require fewer subsidies than before?)

Economy
(1) Has the taxation system been reformed? (What areas have and have not been overhauled? To what degree are taxpayers complying? Has the level of revenues increased? Is the revenue-collection body overburdened?)
(2) Does macroeconomic policy encourage private savings, investment and earnings? (Has there been any reform/alteration of revenue and budget policies? How have any such changes served to advance economic objectives?)
(3) Are property rights guaranteed? (Are there both formal and de facto protections of private real estate and intellectual property? Is there a land registry with the authority and capability to ensure accurate recording of who owns what? What are the procedures for expropriation, including measures for compensation and challenge?)
(4) Is it possible to own and operate a business? (Has there been legislation regarding the formation, dissolution and transfer of businesses, and is the law respected? Do there exist overly cumbersome bureaucratic hurdles that effectively hinder the ability to own and dispose of a business? Are citizens given access to information on commercial law? Is the law applied fairly?)
(5) Is business competition encouraged? (Are monopolistic practices limited in law and in practice? If so, how? To what degree is "insider" dealing a hindrance to open competition?)
(6) Are foreign investment and international trade encouraged? (To what degree has there been simplification/overhaul of customs and tariff procedures, and are these applied fairly? To what degree is foreign investment encouraged or constrained? Is the country overly trade dependent on one or two other countries?)
(7) Has there been reform of the banking sector? (Is the central bank independent? What are its responsibilities? Is it effective in setting and/or implementing monetary policy? What is the actual

state of the private banking sector? Does it conform to international standards? Are depositories protected?)
(8) Is there a functioning capital market infrastructure? (Are there existing or planned commodities, bond and stock markets? What are the mechanisms for investment and lending?)
(9) Has there been reform of the energy sector? (To what degree has the energy sector been restructured? Is the energy sector more varied, and is it open to private competition? Is the country overly dependent on one or two other countries for energy [including whether exported fuels must pass through one or more countries to reach markets]?)

C. Democratic Freedoms: Elaboration of Freedom House's Rating Scheme of Political Rights and Civil Liberties

Freedom House annually rates political rights and civil liberties separately on a seven-category scale, 1 representing the most free and 7 the least free. The 1995-1996 Survey included 191 countries and/or territories. The 1-to-7 rating is derived by country teams awarding from 0 to 4 raw points per checklist item (shown below). The highest possible score for political rights is 32 points, based on up to 4 points for each of eight questions. The highest possible score for civil liberties is 52 points, based on up to 4 points for each of thirteen questions. Under the methodology, raw points correspond to category numbers as follows:

Political Rights category number	Raw points
1	28-32
2	23-27
3	19-22
4	14-18
5	10-13
6	5-9
7	0-4

Civil Liberties category number	Raw points
1	45-52
2	38-44
3	30-37
4	23-29
5	15-22
6	8-14
7	0-7

Political Rights checklist

1. Is the head of state and/or head of government or other chief authority elected through free and fair elections?
2. Are the legislative representatives elected through free and fair elections?
3. Are there fair electoral laws, equal campaigning opportunities, fair polling and honest tabulation of ballots?
4. Are the voters able to endow their freely elected representatives with real power?
5. Do the people have the right to organize in different political parties or other competitive political groupings of their choice, and is the system open to the rise and fall of these competing parties or groupings?
6. Is there a significant opposition vote, de facto opposition power, and a realistic possibility for the opposition to increase its support or gain power through elections?
7. Are the people free from domination by the military, foreign powers, totalitarian parties, religious hierarchies, economic oligarchies or any other powerful group?
8. Do cultural, ethnic, religious and other minority groups have reasonable self-determination, self-government, autonomy or participation through informal consensus in the decision-making process?

Civil Liberties checklist

1. Are there free and independent media, literature and other cultural expressions? (Note: In cases where the media are state-controlled but offer pluralistic points of view, the Survey gives the system credit).
2. Is there open public discussion and free private discussion?
3. Is there freedom of assembly and demonstration?
4. Is there freedom of political or quasi-political organization? (Note: This includes political parties, civic associations, ad hoc groups and so forth.)
5. Are citizens equal under the law, with access to an independent, nondiscriminatory judiciary, and are they respected by the security forces?
6. Is there protection from political terror, and from unjustified imprisonment, exile or torture, whether by groups that support or oppose the system, and freedom from war or insurgency situations? (Note: Freedom from war and insurgency situations enhances the liberties in a free society, but the absence of wars and insurgencies does not in itself make an unfree society free.)
7. Are there free trade unions and peasant organizations or equivalents, and is there effective collective bargaining?
8. Are there free professional and other private organizations?
9. Are there free businesses or cooperatives?
10. Are there free religious institutions and free private and public religious expressions?
11. Are there personal social freedoms, which include such aspects as gender equality, property rights, freedom of movement, choice of residence, and choice of marriage and size of family?
12. Is there equality of opportunity, which includes freedom from exploitation by or dependency

on landlords, employers, union leaders, bureaucrats or any other type of denigrating obstacle to a share of legitimate economic gains?
13. Is there freedom from extreme government indifference and corruption?

Political Rights

1 Rating. Generally speaking, places rated 1 come closest to the ideals suggested by the checklist questions, beginning with free and fair elections. Those elected rule. There are competitive parties or other competitive political groupings, and the opposition has an important role and power. These entities have self-determination or an extremely high degree of autonomy. Usually, those rated 1 have self-determination for minority groups or their participation in government through informal consensus. With the exception of such entities as tiny island countries, these countries and territories have decentralized political power and free sub-national elections.

2 Rating. Such factors as gross political corruption, violence, political discrimination against minorities, and foreign or military influence on politics may be present, and weaken the quality of democracy.

3,4, and 5 Ratings. The same factors that weaken freedom in category 2 may also undermine political rights in categories 3,4, and 5. Other damaging conditions may be at work as well, including civil war, very strong military involvement in politics, lingering royal power, unfair elections and one-party dominance. However, states and territories in these categories may still have some elements of political rights such as the freedom to organize nongovernmental parties and quasi-political groups, reasonably free referenda, or other significant means of popular influence on government.

6 Rating. Typically, such states have systems ruled by military juntas, one-party dictatorships, religious hierarchies and autocrats. These regimes may allow only some minimal manifestation of political rights such as competitive local elections or some degree of representation or autonomy for minorities. Category 6 also contains some countries in the early or aborted stages of democratic transition. A few states in Category 6 are traditional monarchies that mitigate their relative lack of political rights through the use of consultation with their subjects, toleration of political discussion, and acceptance of petitions from the ruled.

7 Rating. This includes places where political rights are absent or virtually nonexistent due to the extremely oppressive nature of the regime or extreme oppression in combination with civil war. A country or territory may also join this category when extreme violence and warlordism dominate the people in the absence of an authoritative, functioning central government.

Civil Liberties

1 Rating. This includes countries and territories that generally have the highest levels of freedoms

and opportunities for the individual. Places in this category may still have problems in civil liberties, but they lose partial credit in only a limited number of areas.

2 Rating. Places in this category, while not as free as those in 1, are still relatively high on the scale. These countries have deficiencies in several aspects of civil liberties, but still receive most available credit.

3, 4, and 5 Ratings. Places in these categories range from ones that receive at least partial credit on virtually all checklist questions to those that have a mixture of good civil liberties scores in some areas and zero or partial credit in others. As one moves down the scale below category 2, the level of oppression increases, especially in the areas of censorship, political terror and the prevention of free association. There are also many cases in which groups opposed to the state carry out political terror that undermines other freedoms. That means that a poor rating for a country is not necessarily a comment on the intentions of the government. The rating may simply reflect the real restrictions on liberty which can be caused by non-governmental terror.

6 Rating. Typically, at category 6 in civil liberties, countries and territories have few partial rights. For example, a country might have some religious freedom, some personal social freedoms, some highly restricted private business activity, and relatively free private discussion. In general, people in these states and territories experience severely restricted expression and association. There are almost always political prisoners and other manifestations of political terror.

7 Rating. At category 7, countries and territories have virtually no freedom. An overwhelming and justified fear of repression characterizes the society.

D. Democratic Freedoms Disaggregated: Elaboration of Freedom House's Rating Scheme in its Nations in Transit 1997

In its Nations in Transit 1997, Freedom House measures progress towards democratic freedoms by assessing a series of questions in five categories: (1) political process; (2) civil society; (3) independent media; (4) rule of law; and (5) governance and public administration. Progress towards each category is rated on a seven-category scale, 1 representing the most advanced and 7 the least advanced.

<u>Political process</u>

(1) When did national legislative elections occur?
(2) When did presidential elections occur?
(3) Is the electoral system multiparty-based? Are there at least two viable political parties functioning at all levels of government?
(4) How many parties have been legalized?
(5) What proportion of the population belongs to political parties?

(6) What has been the trend of voter turnout at the municipal, provincial and national levels in recent years?

Civil Society

(1) How many nongovernmental organizations have come into existence since 1988? How many charitable/nonprofit organizations?
(2) What forms of interest group participation in politics are legal?
(3) Are there free trade unions?
(4) What is the numerical/proportional membership of farmers' groups, small business associations, etc?

Independent Media

(1) Are there legal protections for press freedoms?
(2) Are there legal penalties for libeling officials? Are there legal penalties for "irresponsible" journalism?
(3) What proportion of the media is privatized?
(4) Are the private media financially viable?
(5) Are the media editorially independent?
(6) Is the distribution system for newspapers privately or governmentally controlled?
(7) What has been the trend in press freedom?

Rule of Law

(1) Is there a post-Communist constitution?
(2) Does the constitutional framework provide for human rights? Do the human rights include business and property rights?
(3) Has there been basic reform of the criminal code/criminal law?
(4) Do most judges rule fairly and impartially? How many remain from the Communist era?
(5) Are the courts free of political control and influence? Are the courts linked directly to the Ministry of Justice or any other executive body?
(6) What proportion of lawyers is in private practice?
(7) Does the state provide public defenders?
(8) Has there been a comprehensive reform of antibias/discrimination laws, including protection of ethnic minorities?

Governance and Public Administration

(1) Is the legislature the effective rule-making institution?
(2) Is substantial power decentralized to subnational levels of government?
(3) Are subnational officials chosen in free and fair elections?
(4) Do legislative bodies actually function?
(5) Do the executive and legislative bodies operate openly and with transparency?
(6) Do municipal governments have sufficient revenues to carry out their duties? Do municipal governments have control of their own local budgets? Do they raise revenues autonomously or

from the central state budget?
(7) Do the elected local leaders and local civil servants know how to manage municipal governments effectively?
(8) When did the constitutional/legislative changes on local power come into effect? Has there been a reform of the civil service code/system? Are local civil servants employees of the local or central government?

APPENDIX II: THE UNOFFICIAL ECONOMY

This appendix derives in part from the recognition during the inter-agency reviews in January 1997 that the official statistics do not reveal the full picture. This is a very preliminary attempt to address such concerns, and one that needs to be fleshed out further.

We know that the extent of unofficial economic activity in the transition economies is significant as well as the growth of such activity in some cases during the transition. There is no shortage of estimates of the size of the informal economy. The challenge is to arrive at some reasonable estimates that can be credibly compared across countries as well as over time. The work of Daniel Kaufmann and colleagues may serve at least as a basis for departure in this regard.[20]

As displayed in Table 1, Johnson, Kaufmann and Shleifer (1997) estimate the unofficial economy for seventeen transition economies. These are the countries for which data are available and reasonably reliable. Baseline 1989 estimates of the share of the unofficial economy were derived from country-specific microestimates available from independent sources.[21] As a proxy for total economic activity (official and unofficial), aggregate electricity consumption is used. There is empirical basis that overall economic activity and electricity consumption move hand-in-hand with an electricity/GDP elasticity usually close to one.[22] A ten percent increase in electricity consumption, for example, would correspond roughly with ten percent growth of GDP.

The difference between the growth in electricity consumption and the change in official GDP estimates is the growth of the unofficial economy. Three different estimates of the size of the unofficial economy, based on different assumptions of the electricity/GDP elasticity, were calculated to assess how sensitive are results to changes in the method of calculating. The results of Table 1 represent the middle (of the three) estimates. At any rate, the difference in the results from the three scenarios is quite small; on average, the size of the unofficial economies as a percent of GDP varies by three percent.

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[20]See in particular: D. Kaufmann and A. Kaliberda, "Integrating the Unofficial Economy into the Dynamics of Post-Socialist Economies: A Framework of Analysis and Evidence", pp. 81-120, in *Economic Transition in Russia and the New States of Eurasia* (Bartlomiej Kaminski, ed., Armonk, N.Y.: M.E. Sharpe, 1996); and S. Johnson, D. Kaufmann, and A. Shleifer, "Politics and Entrepreneurship in Transition Economies," Working Paper Series, No. 57, The William Davidson Institute, University of Michigan (1997).

[21]Estimates of the size of the unofficial economy in the Soviet Union in 1989 ranged from ten to fifteen percent of official GDP; twelve percent, the midpoint estimate, is hence used as the baseline for countries of the FSU.

[22]Istvan Dobozi and Gerhard Pohl, "Real Output Decline in Transition Economies—Forget GDP, Try Power Consumption Data," *Transition Newsletter*, World Bank, Vol. 6, January-February 1995.

The findings are striking. First, the unofficial economy is significant in all countries. However, the variation across the countries is also significant. In the NIS, the unofficial economy is almost forty percent of overall economic activity; in the CEE it is closer to twenty percent.

The two regions differ substantially in trends over time in the unofficial economy as well. The growth of the unofficial economy has likely peaked for many of the CEE countries, particularly the Northern Tier countries (perhaps except Latvia). In fact, from 1989-1995, the growth of the unofficial economy in the CEE has been negligible. In contrast, the unofficial economy on average in the NIS has more than tripled from 1989 to 1995 and is likely still growing in most of the NIS.

Several factors seem to play a role in the size and growth of the unofficial economies. Taken together, these factors may go far towards explaining the variations across countries. Specifically, one might expect to find a particularly large unofficial economy where: (1) political liberalization has gone forth (and with it bureaucratic autonomy and discretion in applying regulations); (2) the legal institutional framework is weak (and hence the costs of operating in the unofficial economy low); (3) there has been an absence of economic liberalization and (4) macroeconomic stability (and with it few incentives to operate in the formal economy); (5) high and volatile tax rates exist (which again provide few incentives to go official); and (6) the demand for services and trade is substantial (activities, i.e., that may be more conducive to operating in the unofficial economy than others).

Explicitly bringing unofficial economic activity into the picture also brings to the fore some policy implications. In particular, should unofficial economic activity be discouraged. And if so, how?

On the one hand, such activity has helped cushion the hardships of transition. In fact, those countries which experienced a particularly large decrease in official economic activity, also tended to experience a relatively large increase in unofficial economic activity.

Yet, over the longer term, unofficial economic activity clearly poses a drag to the overall economy. It impedes the ability of the state to govern (by undermining the integrity of the tax system) and to maintain macroeconomic stability. And it discourages economic growth. The unofficial economy is largely a survival economy focused on the short-term. Enterprise development hinges on access to financial capital, and this can only occur in any substantial way through participation in the official economy.

Finally, if there is validity to the above-mentioned determinants of the unofficial economy, then the importance of moving decisively in economic policy reforms is further underscored, particularly in countries with large unofficial economies. The objective is to bring unofficial economic activity into the official economy. The sooner the economy is liberalized and stabilized, and accompanied by the development of rule of law and the related institutional enforcement mechanisms, the sooner the appropriate incentives are in place for firms and individuals to participate in the official economy.

Appendix II. Table 1. Unofficial Economy as Share of Official GDP

Country	1989	1990	1991	1992	1993	1994	1995	Difference 1989-1995	Difference 1994-1995
Slovakia	6.0	7.7	15.1	17.6	16.2	14.6	5.8	-0.2	-8.8
Uzbekistan	12.0	11.4	7.8	11.7	10.1	9.5	6.5	-5.5	-3.0
Czech Republic	6.0	6.7	12.9	16.9	16.9	17.6	11.3	5.3	-6.3
Estonia	12.0	19.9	26.2	25.4	24.1	25.1	11.8	-0.2	-13.3
Poland	15.7	...	23.5	19.7	18.5	15.2	12.6	-3.1	-2.6
Romania	22.3	13.7	15.7	18.0	16.4	17.4	19.1	-3.2	1.7
Belarus	12.0	15.4	16.6	13.2	11.0	18.9	19.3	7.3	0.4
Lithuania	12.0	11.3	21.8	39.2	31.7	28.7	21.6	9.6	-7.1
Hungary	27.0	28.0	32.9	30.6	28.5	27.7	29.0	2.0	1.3
Kazakhstan	12.0	17.0	19.7	24.9	27.2	34.1	34.3	22.3	0.2
Latvia	12.0	12.8	19.0	34.3	31.0	34.2	35.3	23.3	1.1
Moldova	12.0	18.1	27.1	37.3	34.0	39.7	35.7	23.7	-4.0
Bulgaria	22.8	25.1	23.9	25.0	29.9	29.1	36.2	13.4	7.1
Russia	12.0	14.7	23.5	32.8	36.7	40.3	41.6	29.6	1.3
Ukraine	12.0	16.3	25.6	33.6	38.0	45.7	48.9	36.9	3.2
Azerbaijan	12.9	21.9	22.7	39.2	51.2	58.0	60.6	47.7	2.6
Georgia	12.0	24.9	36.0	52.3	61.0	63.5	62.6	50.6	-0.9
CEE & NIS	13	15	22	28	30	33	33	20	0
CEE	17	16	21	22	21	19	18	1	-1
NIS	12	15	22	30	34	38	39	27	1

Source: S. Johnson, D. Kaufmann, and A. Shleifer, "Politics and Entrepreneurship in Transition Economies," *Working Paper Series*, No. 57, The William Davidson Institute, University of Michigan (1997), reproduced in EBRD, *Transition Report 1997* (November 1997).